April 15, 2013

Honorable Diane Black, Chairwoman, Education & Family Benefits
Tax-Reform Working Group of the House Ways & Means Committee
Honorable Danny Davis, Vice Chairman, Education & Family Benefits
Tax-Reform Working Group of the House Ways & Means Committee

Dear Representatives Black and Davis:

In the interests of informing and aiding your tax-reform discussion, we appreciate the opportunity to share with you the following pages of background on several aspects of the federal tax code with which we are most familiar, as well as select recommendations for improvements that would help working taxpayers and their families throughout our nation.

Ensuring that our tax system works for working families is central to the mission of the National Community Tax Coalition. Our more than 2,400 members are primarily involved in Volunteer Income Tax Assistance (VITA) services: programs that bolster tax compliance by leveraging the help of well-trained and certified volunteers to provide free tax preparation to low- to moderate-income, working families. Overall, Community VITA programs aided more than 1.6 million taxpayers in filing their returns last year. This helped struggling taxpayers in need of filing assistance to avoid paying the often-exorbitant fees charged by commercial preparers, so that working families could retain the full amount of any tax refund for which they qualified.

VITA further aids families' movement toward greater independence and stability, as many VITA programs also provide their clients with financial-education services and such asset-building help as opening savings accounts. It's on this base of knowledge, working alongside families and witnessing their day-to-day struggles, that we build the tax-reform recommendations that we provide here – recommendations we also will share with several other Ways & Means working groups whose purviews seem appropriate.

We strongly believe strengthening VITA – not to mention the Earned Income Tax Credit, Child Tax Credit, American Opportunity Tax Credit, and several other significant tax-code priorities – is essential to the stated intentions of Ways & Means' tax-reform examination, as well as parallel work taking place in the Senate Finance Committee.

"Regardless of party or politics, everyone can agree that comprehensive tax reform should result in a simpler, fairer tax code for families and more jobs for American workers," Ways & Means Chairman Camp stated Feb. 13 in forming the Committee's working groups. Ranking Member Levin added that it's important to get a firm grasp on the tax system's current particulars to help envision "a path to a simpler, fairer and adequate tax code." Along those lines, NCTC last year identified some basic, commonsense principles to help guide any tax-reform approach that's serious about buttressing the nation’s financial *(see tinyurl.com/NCTC-tax-reform-principles)*. We singled-out the need to prioritize:

- **Fairness** – We must improve the fundamental fairness of our tax system, particularly for those who lack it most: America’s low- to moderate-income, working families. Struggling families already pay a significant amount in federal taxes, as well as state and local taxes, and should not be asked to give more. The information and suggestions we provide will help you pursue the goal of furthering fairness.

- **Simplicity** – Our tax code should be made simpler in ways that serve the greatest, common good. Protecting and greatly strengthening VITA services – helping taxpayers find their way through the tax code – is the foremost recommendation we can make in this regard, and is well-detailed in the following pages. We caution against conflating and flattening tax rates too aggressively, and thereby eroding progressivity in the name of “simplicity.”

- **Adequacy** – Our tax system must raise enough in revenues to ensure we can pay our nation’s bills. Yet, too many important examples demonstrate that is not the case today. A wide range of significant education, health care, and human services already faced enormous and growing strains before the adoption of indiscriminate and unwise sequestration cuts that will fall primarily on families in greatest need over the next decade.

Congress’ recent deficit-reduction moves have directed about $4 in cuts for every $1 in new revenues raised, an imbalanced approach that greatly undermines the well-being of working families, eliminates jobs, and counters our nation’s efforts at economic recovery. Thus, we strongly encourage Congress to take this opportunity to step-back and design tax reforms that introduce better balance to the mix – producing greater revenues for our most pressing needs while avoiding the danger of raising taxes on low- to moderate-income, working households.

“We will ensure that low-income and middle-income Americans will pay no more in taxes than they do under current law,” Ways & Means Chairman Camp and Senate Finance Chairman Baucus pledged in an op-ed the Wall Street Journal printed April 8. And, they added, “(T)ax reform should result in a system that is as progressive as the current one.” We applaud that pledge and urge you to go even further, making our tax code even more progressive, while taking steps to bolster needed revenues.

We offer our ongoing assistance in these important efforts, and would be happy to provide you with further information. We thank you for the opportunity to help improve the tax code in ways that – in turn – improve the well-being of hardworking families and the economy of our nation.

Sincerely,

Jackie Lynn Coleman
Executive Director

VOLUNTEER INCOME TAX ASSISTANCE (VITA)

The VITA program represents one of the single best routes toward "simplification," helping low- and moderate-income, working taxpayers deal with the complexities of the federal tax code, not to mention state tax laws. In addition to its free assistance with preparing and filing tax returns, many VITA programs also offer financial-education and asset-building services, such as help with opening a savings account and establishing a household budget. VITA not only helps working families to comply with their tax obligations as Americans, but to move toward greater financial security – thus strengthening the economic stability of our entire nation.

This is the kind of assistance that will long remain vitally important to many working families, regardless of the success of any other efforts toward making our tax system easier to understand. The fact is that many households will still want some help navigating an often dizzying array of tax forms, schedules, filing requirements, definitions, etc. For many, such help is as necessary as it is desirable – as their other options include commercial tax preparers who often charge hundreds of dollars in fees. Yet VITA is there to provide such assistance and a greater sense of security wherever it can, free of charge. And as taxpayers get the help they need, many become familiar and comfortable enough with the filing process to "graduate" into filing their own taxes in subsequent years.

VITA builds on the American spirit and tradition of volunteerism. It relies on the help of tens of thousands of volunteers who undertake rigorous training, competency testing, and IRS certification to demonstrate their own understanding of the tax code and filing fundamentals, as well as their capacity to help other taxpayers with those details. These volunteers leverage an extremely limited amount of federal funding to do a world of good, bringing non-filers into the tax administration system and instilling a greater sense of civic responsibility among all participants – from client families and volunteers to trusted partners at community-based organizations.

However, increasing funding constraints and growing responsibilities combine to force the sobering question, "How long might VITA be around to continue offering taxpayers this free assistance?" Particularly in light of ongoing IRS budget cuts, which already have deeply affected other taxpayer services – with fallout effects for VITA – more must be done, and soon, to shore-up these vital services and provide working families with any kind of reassuring answer to that question.

<u>Who benefits from VITA, and how?</u>

VITA helps taxpayers in every state, nationwide. Community-based VITA programs operated at more than 5,700 sites in the 2012 filing season, helping more than 1.6 million taxpayers to file federal income-tax returns. The program particularly aims to help underserved and often hard-to-reach taxpayer populations, such as persons with disabilities, the elderly, Native Americans, residents of rural America, and those with limited English proficiency. In all, VITA assists those taxpayers who generally need help the most – families earning less than about $50,000. (In recent filing seasons, VITA clients' average Adjusted Gross Income came closer to $20,000.)

Many of these families face such confusing matters as juggling multiple W-2s from holding-down various jobs, yet they also struggle to handle the exorbitant fees often charged by commercial tax preparers – costs that run as high as $200, $300, or more.

It is significant to note that, as the result of a January 2013 decision by the U.S. District Court for the District of Columbia in the case of *Loving v. IRS* – D.C. Circ., No. 13-5061 – such commercial tax preparers are not currently subject to training, testing, and certification standards. This is particularly disturbing, considering the fact that commercial preparers handle an estimated two-thirds of all returns claiming the Earned Income Tax Credit. Moreover, there have been numerous, well-documented cases of fraud and abuse by unscrupulous or incompetent paid preparers – people who have access to taxpayers' most sensitive and personal financial information. Clearly, basic regulation of commercial tax preparers should be reinstated to provide baseline consumer protections. Note that attorneys, Enrolled Agents, and Certified Public Accountants who prepare taxes were neither affected by this decision nor the IRS regulations in question; they already are subject to their own licensing standards and rules. *(See tinyurl.com/going-to-court-for-consumers, for more information.)*

VITA's free-of-charge services help working families to avoid needlessly incurring paid-preparation costs, thus also helping them hang-onto the full amount of any tax refunds for which they qualify. This in turn helps protect working parents' abilities to handle an intimidating range of costly, day-to-day challenges, such as rent, groceries, utility bills, car repairs, and so forth. In fact, VITA helps improve working families' awareness of the tax credits for which they're eligible, and which they might otherwise overlook. The IRS notes that as many as one in four or five taxpayers eligible for the EITC fails to claim it – underscoring the importance of the kind of assistance that VITA represents.

Marks of VITA's success

VITA has a proven track record of success over its more than 40 years of life, providing high-quality service to client taxpayers. In the 2012 filing season, such free, volunteer-based programs posted an accuracy rate of 92 percent among the returns they helped taxpayers file, according to the IRS' Quality Statistical Sample (QSS) study. This represented a 5-percentage-point leap from the previous year, and a nearly 14-point increase since 2009 – likely reflecting more rigorous training and other initiatives pursued in recent years by the VITA field and the IRS Stakeholder Partnerships, Education, and Communication (SPEC) office. Significantly, the Treasury Inspector General for Tax Administration (TIGTA) acknowledges the QSS study to represent a more statistically sound gauge of volunteer-prepared returns' accuracy than its own, narrower measure provides.

Among other measures of VITA success are the savings it represents for taxpayers collectively. Volunteer tax-prep programs such as VITA post an electronic-filing rate of about 95 percent, compared with a national average of about 80 percent. And because it is far cheaper to handle e-filed tax returns than paper copies, volunteer tax preparation programs save the IRS an estimated $5.5 million in annual processing costs. In addition, electronic filing yields an error rate 10 times lower than that of paper returns, helping to further boost VITA accuracy as well as increase quality, compliance, efficiency, and further savings for the government and all taxpayers.

However, in assessing VITA's achievements, it is important to note the program has essentially become a victim of its own success, too. VITA's overall output has increased substantially in recent years, rising by 220 percent between the 2004 and 2012 tax-filing seasons. Yet taxpayers' needs for VITA help – and the government's growing demands on the program – continue to outstrip the program's current capacity and resources.

Indirect pressures – with very direct effects on VITA

Deep budget cuts have reduced the IRS' strength by 8,000 staff positions in the last two years, agency officials recently reported. That figure includes the loss of at least 2,000 taxpayer-services employees through early March 2012 – a time by which IRS Taxpayer Assistance Centers (TACs) had served 5 percent fewer taxpayers than in the previous year, and were actively referring people to VITA sites for help. This sad trend of cutbacks continued into FY2013, during which time TACs were projected to serve nearly 12 percent fewer taxpayers than the previous year, according to a recent TIGTA report. This is but one illustration of the ways VITA is forced to shoulder increasing responsibilities when other taxpayer assistance options shrink or disappear.

In another snapshot of increasing burdens, VITA programs were left this filing season with the responsibility of printing – at their own expense – some critical materials needed to support their free-of-charge services. An example is Publication 4012, the Volunteer Resource Guide, which runs 208 pages long and represents only one of the materials needed by VITA programs, their site managers, or their volunteers. Only minimal printed copies were made available.

Such pressures are more likely to grow than abate over the coming months and years, under the effects of sequestration (and/or the adoption of any alternative measures for federal deficit reduction). Furthermore, these examples do not take into account the even more direct pressures represented by the VITA's rapidly dwindling resources.

Resource constraints on VITA, from all levels

Those states and local governments that provide funding help for VITA have largely been slashing that assistance in recent years. While admittedly unscientific, a 2012 NCTC survey – in which VITA providers from 29 states and the District of Columbia took part – is nonetheless instructive. Providers from 12 states said their VITA programs had received at least some state dollars. But such funds were decreasing in eight of those states, and increasing in only one. The same, eight-to-one ratio of losses to gains held true for respondents reporting the receipt of local government resources. Preliminary results from a more recent survey of NCTC members do not paint a much rosier picture; few programs indicate the restoration of substantial funding that had been cut. And other, philanthropic funding has not fared particularly well in recent years, either.

At the federal level, VITA programs can apply for funding from a grant program that began in 2008. While the Community VITA Matching Grant increased in 2011 to $12 million (from $7.4 million), it has held steady at that amount since – even as the needs of its clients and the responsibilities imposed by the IRS have grown. Now, along with many other critical priorities for working families, the VITA grant faces the prospect of nearly a decade's worth of sequestration cuts – leaving one to wonder how much of its $12 million could be left at the end.

Each of the last several years, VITA's federal grant applicants have sought about $28 million to $33 million in funding – more than double the amount of resources actually available. In addition, the number of grant applicants always far outstrips the number of awards that can be made to support vital, community-based services. The 2013 grant cycle saw 333 applicants, but only 206 grants made; the previous year, 371 programs sought grant help, but only 213 were successful. Apportioned among 333 grantees, VITA's federal dollars are quickly stretched thin – and then, stretched even further as they're divided among such program fundamentals as:

- Volunteer recruitment, training, recognition, and tax-season support
- Staff management (administration, supervision), and research
- Setting-up computers with software, tax-season software maintenance and IT support
- Program outreach efforts

Exacerbating these resource woes is the fact that even if a VITA program would like to do so, it cannot introduce the most nominal of fees to recover any of its administrative costs for providing tax-preparation services. Thus, this program – which helps the government and individual, struggling taxpayers so much – is nearly entirely dependent upon the help of government and philanthropic fundraising, in addition to whatever limited, permissible fundraising it can undertake on its own.

<u>Recommendations for strengthening VITA for working families</u>

In order to help maintain VITA viability and sustainability for the families who currently turn to its help – let alone to handle more of its unmet needs – several important changes are necessary. Some of these are embodied in the VITA Act legislation (H.R. 341), which would strengthen the VITA grant in various ways. These include:

- Officially authorizing the grant program in the tax code. Currently, the VITA grant retains the equivalent of demonstration-grant status.
- Authorizing (but not requiring) annual grant funding of up to $30 million for five years, to better-respond to the unmet VITA needs that are consistently reflected in grant applications.
- Establishing a National Center to Promote Quality, Excellence, and Evaluation in VITA with a $5 million annual authorization (again, allowed but not required). This Center would help identify best practices, facilitate technical assistance, and ensure continuation of services for hardworking, taxpaying households.
- Allowing VITA programs greater flexibility to meet local needs, by letting them put these federal grant dollars toward asset-building and financial-education efforts, as well as the tax-preparation work that currently constitutes their only permissible use.

These measures represent fundamental, common-sense considerations for inclusion in any tax-reform approach that is serious about strengthening the fairness of our tax system, aiding the simplification of the tax-filing process for working families, and maintaining basic tax-compliance efforts.

EARNED INCOME TAX CREDIT (EITC)

For good reason, the EITC has become widely known as the most powerful federal-policy tool for keeping families out of poverty. In recent years, according to the Brookings Institution, the credit has been responsible for keeping an average of 6.1 million people out of poverty – about half of them children – while reducing the effects of poverty for another 21.2 million people.

The many benefits of the EITC are well-documented, but bear repeating: The credit reflects, rewards, and incents hard work, as it's available only to taxpayers who work and have earned income. It helps families to cover their basics, ranging from groceries and rent to utility bills and car repairs. More recent research suggests that families typically claim the credit only for temporary stretches; three out of five families claimed it for only one to two years at a time, according to a study published in Public Finance Review in 2011. Moreover, an ever-growing body of research demonstrates important EITC connections with better education outcomes among children (such as stronger math and reading test scores) and family health outcomes (including decreases in maternal smoking and increases in infants' birthweights).

Some studies have revealed a higher percentage of rural tax-filers claiming the EITC than urban filers. And the credit not only helps individual households to establish or build upon their savings, it helps to boost the health of local economies as families spend their EITC dollars at small, neighborhood businesses. *(See tinyurl.com/13for13 for a brief overview and citation of the these datapoints, as well as tinyurl.com/EITC-paper-2012 for a longer paper NCTC published on the EITC in 2012.)*

To protect and improve upon this crucial help for working families, we should strengthen the EITC. The American Taxpayer Relief Act of 2012 (ATRA) represented a good first step. It made permanent a layer of "marriage penalty" relief that was enacted in 2001 and raised by $3,000 the income level at which the credit begins to phase-out – and then disappear – for married couples, indexed for inflation. This helps to offset the "penalty" that married couples often feel when the amount of their EITC falls short of the sum of the EITCs they'd have received when still single.

That layer of relief is superseded by another such layer that was enacted in 2009, increasing by $5,000 the earnings level at which the credit phases-out for married couples. However, this higher phase-out was extended by ATRA for only five years – even as the law permanently extended such measures as generous federal estate tax rates, which help only a minute fraction of very wealthy households. Similarly, ATRA extended only temporarily the tier of extra EITC assistance that was established in 2009 for working families with three or more children. Under that policy improvement, the EITC represents 45 percent of households' first $12,570 in earnings (increased from 40 percent). Without that help, the maximum credit for a family with children would have dropped significantly, by $655.

These two, temporarily extended measures represent an average of about $530 each to about 6.5 million families, according to Citizens for Tax Justice. This demonstrates their significance – and underscores why we should not risk allowing these provisions to lapse. Struggling families' day-to-day lives already are heavily stamped with too much uncertainty, and we should not add to it. We should take steps now to maintain these priorities for the families who will need them.

Moreover, we should further build on the strengths of the credit by increasing the size of the far-too-small EITC for which childless taxpayers qualify. This is one shortcoming of the EITC that researchers, policymakers, advocates, and others long have identified as in need of repairs. For example, the credit's current maximum amount is $475 for single taxpayers with no qualifying kids – impoverished taxpayers, who earn as little as $6,210 to $7,770. That credit amount, in turn, represents as little as 6.1 percent of their annual incomes. And it's less than one-third the percentage of the maximum, $3,169 credit for a single filer with one qualifying child (earning between $9,320 and $17,090).

Raising the amount of the EITC for childless, working taxpayers would correct a longstanding injustice, and help incent even more single, childless Americans to enter and remain in the workforce.

CHILD TAX CREDIT (CTC)

Much like the EITC, the CTC is known for helping to keep millions of Americans out of poverty and on a path toward self-sufficiency. It is laser-focused on the needs of households incurring the costs of raising kids.

In describing the CTC's establishment, a 2008 report by the Congressional Research Service noted that, "Congress acted so that the child tax credit would reduce a family's tax liabilities, would better recognize the financial responsibilities of child rearing, and would promote family values." Even as lawmakers disagreed on some of its finer policy points, the report added, the CTC "enjoyed broad support across the political spectrum." It should today, too, as its stated purposes are no less important than when it was created 16 years ago.

As with the EITC, the steps taken by ATRA included a good start toward shoring-up the CTC's critical assistance for working families. That law made permanent the credit's $1,000 per-child maximum, preventing it from being halved. Yet, ATRA extended for only five years a lowered income-eligibility threshold for the credit's refundable portion. This measure was adopted in 2009 and allowed earnings over $3,000 to be counted toward the CTC, providing greater help to more of the nation's most impoverished families. It replaced a higher, inflation-adjusted benchmark that currently represents about $13,000 of income – and will be higher still when the temporary provision is set to expire.

This lowered earnings threshold represent, on average, $854 to each of nearly 9 million families, according to Citizens for Tax Justice. Parents who struggle to provide for their children should not have to face such a loss, which would deal a terrible blow to their ability to keep their kids healthy, fed, and decently housed.

We should act now to make that CTC threshold permanent – and we should continue to resist suggestions that would restrict the credit's refundable portion in ways that would hurt many of the most vulnerable and poverty-stricken families raising children.

AMERICAN OPPORTUNITY TAX CREDIT (AOTC)

In 2009, a significant change was made to the tax code that has increased the affordability of postsecondary education for low- and moderate-income students and their families. As it did with other key tax credits, the American Recovery and Reinvestment Act greatly enhanced the existing Hope Credit for higher-education purposes by temporarily transforming it into the partially refundable AOTC. This credit provides low- and moderate-income taxpayers up to a $1,000 refund for qualified education expenses, which allowed more than 13 million households to receive some support from the credit in Tax Year 2010 alone, as reported in the most current data of the IRS Statistics of Income Division.

This support is essential to reducing the stress of higher-education costs – helping more students to be able to afford college entry as well as ensuring enrolled students progress through to degree attainment and workforce development, placing them on the path to personal financial growth associated with this achievement.

At the very minimum, the AOTC must be made permanent. The current provisions of the tax code would let the AOTC revert back to the nonrefundable Hope Credit after 2017, eliminating billions of dollars annually in support for hardworking families already struggling to put their children through college. This is a loss that cannot be risked, but it also does not mean that we should not seek to improve upon the credit's current structure and increase this support for the families who need it most.

In May 2011, NCTC introduced one such proposal for creating a single higher-education tax credit that would achieve this goal *(see tinyurl.com/higher-ed-paper*). Among the most significant concepts of this proposal that we believe Congress should consider are these:

- Better-target the credit to the low- and moderate-income households who stand to benefit the most.
- Increase the percentage of the credit that is refundable, to ensure as much support as possible is going directly back into the hands of those who need it.
- Allowing students to maintain the benefit of the credit beyond the first four years of postsecondary education, in order to better-support nontraditional students and graduate-degree pursuits.

SAVINGS-RELATED TAX CREDITS

The current tax code contains many incentives for retirement savings. Unfortunately, it only targets a single tax credit – the Retirement Savings Contributions Credit (commonly known as the "Saver's Credit") – toward low- and moderate-income taxpayers.

The Saver's Credit was initially intended to encourage personal retirement savings by these taxpayers as a means of decreasing dependence on traditional Social Security payments as a source of income, as well as increasing post-retirement financial security. However, the reality of this credit's design – combined with misunderstanding of the savings needs of low- and moderate-income, working families – has demonstrated that this incentive is in need of serious reform. This situation is described in an NCTC report addressing options for encouraging retirement savings *(see tinyurl.com/retirement-savings-paper).*

Nonrefundable credits can only have a small effect on taxpayers who begin with limited tax liabilities, as is typically the case for many low-income tax filers. A reformed credit that provides a tangible incentive, while better-reflecting the various savings needs of working taxpayers – retirement, and otherwise – is necessary. One such approach is to enact the Financial Security Credit proposed by the New America Foundation *(see tinyurl.com/NAF-Financial-Security-Credit).*

This approach envisions a limited, matched credit for low-income taxpayers, for savings deposited in restricted savings products. The proposal would allow these savers to increase their financial security by better-targeting the credit's incentives to their specific savings horizons – from short-term, precautionary savings to long-term, retirement savings – and placing households on more stable footings overall. This approach represents a welcome addition to the policy options for encouraging savings at tax time; more such ideas are necessary, and desirable, to help more Americans pursue greater savings and improve their financial security.

TAX-TIME OPPORTUNITIES TO PURCHASE U.S. SAVINGS BONDS

For 75 years, hardworking Americans and their families had easy access to U.S. Savings Bonds. Yet recent changes in the savings bonds program have made it harder for Americans to access these tried-and-true savings tools – and threaten the long-term survival of the tax-time savings bond policy.

The moment during the tax-preparation process at which taxpayers learn the amount of their refunds has come to be known as a "savable moment." Lower-income families, especially those eligible for tax credits, can receive tax refunds that amount to as much as 20 percent of their annual incomes. For many struggling to make ends meet, it is the only time all year that they can realistically save any money. The ability to split refunds makes it possible for tax filers to capitalize on this opportunity, and keeping savings bonds available on tax Form 8888 makes the purchasing experience simple and convenient.

This tax-time savings bond policy is doing what it was intended to do: helping households save and fostering a habit of saving. In the three years that the policy has been in place, more than 75,000 tax-filers have purchased U.S. Savings Bonds through their tax forms, setting-aside more than $40 million for themselves and their loved ones. Average savings per purchaser grew 70 percent from 2011 to 2012. In 2012, the average amount purchased in savings bonds was $579. Further, there is evidence that the policy is cultivating a strong habit of savings: More than 25 percent of 2010 bond buyers bought again in 2011, and this phenomenon was repeated in 2012.

Currently the U.S. Treasury offers a paper savings bond option, but it's only guaranteed to remain available through the 2014 tax season, due to the growing transition to electronic products. Moreover, the current, web-based system to purchase savings bonds – "Treasury

Direct" – is also deeply flawed. It is not user-friendly, and particularly difficult for populations who might be less technologically savvy, such as older Americans, as well as those with limited access to computers or broadband services, such as low-income, rural and some urban households. The system also requires a user to have a bank account, representing one more needless obstacle for those who truly want to purchase bonds.

We urge Congress to support the retention of this sole, remaining policy for purchasing paper-based U.S. Savings Bonds, as well as to make use of its most attractive features in any new, electronic options. These include:

- "Gifting" – the ability to give a savings bond as a gift, by easily using a portion of tax refunds
- Helping the unbanked – the ability for those without bank accounts to designate a portion of their tax refunds to save in the form of bonds
- Simplicity – the ability to use information already on tax forms to order bonds with minimal or, preferably, no additional information needed.