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Implementing the Earned Income Tax Credit at AccountAbility Minnesota Part B

After working through the risks and benefits, Bonnie Esposito decided to pursue the development of the alternative Refund Anticipation Loan (RAL) product. While there were many risks associated with that choice, including uncertainty about financial and human capital resources, this seemed to be a path which could lead the agency to really help customers and address the implementation problem created by RALs. She now needed to develop the concept further, raise funds, and find partners.

She began by learning more about the pilot program sponsored by Alternative Credit Union in New York and search for other models. The Alternative's model worked because the credit union was both a Voluntary Income Tax Assistance (VITA) site and a financial institution that could directly implement the alternative loan program. As a service-based nonprofit, AccountAbility would need to partner with a financial institution.

Bonnie also needed be realistic about AccountAbility's current organizational capacity. While its size and number of customers had increased in the last three years, the expansion focused in the core agency work—tax preparation—not through the development of additional programs. It was also impossible to know the demand for a quick refund loan among AccountAbility's current customers. Would the new program be a way to attract new customers? This outcome would enable the new initiative to cut to the heart of the problem, reducing the exploitation of some low-income workers. But what scale could the AccountAbility achieve?

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DEVELOPING THE PROGRAM IDEA

In a traditional RAL, the tax preparer collaborates with a bank and creates a temporary account to which the taxpayer's refund can be deposited by the IRS. Once that happens, the loan is considered paid off and the bank account closed, robbing taxpayers of the opportunity to develop an ongoing relationship with a financial institution. Customers are not able to build their credit history or grow their wealth, leaving them vulnerable to take out another RAL the following tax season if they again want quick access to their refunds. To develop an alternative approach, Bonnie needed to start conversations with financial institutions sharing AccountAbility's mission of access for disadvantaged people.

Before doing so, however, she first called the local office of the Internal Revenue Service (IRS). As she explained, "They are an important partner to us. We are dependent upon them for software and computers. The IRS (and Minnesota Department of Revenue) was not a huge fan of RALs. So I strategically called someone there who I had talked with about the problem, to let her know there might be an alternative. I wanted to let her know about the idea before talking to anyone else. And she was thrilled and willing to communicate internally about it." In addition to building some political goodwill, this initial conversation helped Bonnie begin to learn more about some technical details. In particular, she learned about the functioning of the Debt Indicator, which private preparers were mining to identify customers who might be particularly interested in the RALs.

Then she turned to thinking more about potential financial institution partners. A number of years earlier, the US Federal Credit Union had donated some computers to AccountAbility to assist in their build-out of electronic filing capacity. The President, Bill Raker, was a forward thinking leader who started free tax sites at two of their offices. After two years, they were planning on expanding tax preparation to a third site located in their northern suburban office. Bonnie called to run her idea past Bill and see if he had heard of the model. As it turns out, he knew the President of Alternative Credit Union and was eager to get more specific information. Together, they began to consider what type of pilot program might be possible in Minnesota.

To distinguish the program from RALs, they decided to name the new effort the "Express Refund Loan & Savings" program, illustrating both the quick loan and importance of longer-term savings. US Federal had a number of existing financial services: a "Share" or "Preferred" savings account with no minimum balance and no monthly fee; certificates of deposit; Individual Retirement Accounts; free no-minimum balance checking accounts, unlimited check writing, and debit cards useable at over 1,000 surcharge-free ATMs. As Bill said, "When Bonnie explained her ambition to develop an alternative to the Refund Anticipation Loan, I was intrigued by the idea but initially had no concept about how it would work. I knew we were in the business of making loans but we have set processes and underwriting practices, all to protect the assets of the organization and our members." How would the process work in a new context?

Bonnie also began talking to a number of key stakeholders in the field, including the state's Children's Defense Fund, the Office of Economic Opportunity, and potential private funders. She also needed to talk with her board. In initial discussions with the Executive Committee, she encountered resistance. The Refund Anticipation Loans were the pariah of the industry and any association with them could put the organization at risk. Many on her board were accountants,

and they wanted to know all of the details. To help summarize the key elements, she worked with her staff and planners at the Credit Union created a short discussion document for a board meeting (See Appendix B). However, the staff, too, were initially resistant to the idea. The Operations Director wondered, “Would this just be a gimmick to mirror what the paid preparers did? It needed to have value. How we managed the relationships and the build-out was critical. We needed to show how the loan was just a way to bring customers in so they could save money.”

Knowing the focus of the McKnight Foundation’s family economic security portfolio and their interest in expanding access to financial services, Bonnie spoke with the program officer to test her interest in providing funding for a year-long pilot program. The program officer wanted to know more, particularly what the organization was learning about the potential strengths and pitfalls. What did other partners think of this idea? How were those reactions affecting program development? While funders often ask these types of questions, Bonnie realized this co-creation process was particularly important in an initiative like this that required nonprofits, government, and financial institutions to work together. After a number of conversations with the program officer, AccountAbility Minnesota was invited to submit a three-year proposal for the pilot program. The organization requested \$430,000 over that time period, including a reserve pool to help guarantee costs associated with the new credit union product.

The proposal delineated the three-year plan. In the first, the Express Refund Loan & Savings program would be offered at two community-based free tax sites. One site was in south Minneapolis not far from the Credit Union’s branch; the other would be in north Minneapolis, a neighborhood with the highest rate of RALs in the metropolitan area. To show maximum impact, the initiative would target customers who otherwise *would* use a commercial tax preparation service and a RAL. The initiative would save these customers between \$100 and \$300 previously spent at commercial preparers.

The customers’ refund would be direct deposited in a savings account. AccountAbility Minnesota staff would screen customers, complete their tax returns, and initiate obtaining the refund and new savings account. Credit Union staff would complete the transaction and provide people access to their refund the next day, while also introducing customers to the variety of financial services available to them. Altogether, they planned to provide loans to 110 customers in year one, 215 in year two, and 430 in year three, providing approximately \$1.05 million in instant refunds loans through the pilot. They also wanted to begin to replicate the initiative statewide. As Chair of the Minnesota Credit Union Network, Bill Raker promised to leverage his relationship with the 160 member credit unions. Additionally, AccountAbility felt confident it could draw upon its existing relationships in 13 communities where they were providing technical assistance to nonprofits running free tax preparations sites.

With encouragement from the McKnight Foundation, additional details need to be decided. Bonnie drafted a formal agreement with US Federal Credit Union. They agreed that eligible customers could open a savings account and, if they wanted, borrow against their anticipated refund at no cost. Once the IRS deposited the customer’s refund into the credit union account, the loan was considered paid. Customers could then retrieve the remaining amount in the account and close it, or choose to leave it open and access additional financial products, such as checking

accounts, mortgages, and Individual Retirement Accounts. Financial counseling by staff from both organizations could be provided at every step.

It took a long time, though, to work through differences between the two organizations' operations. Credit Union underwriting practices helped to assure the security of loans, but it was not possible to place their staff at the tax sites. Instead, AccountAbility staff would be providing initial access to the accounts where the IRS could deposit the return. Yet those account numbers needed to be protected and assigned by Credit Union staff. As Bill Raker explained, "To have someone from outside the credit union assign the account numbers seemed to be insurmountable. We didn't want the control of the numbers outside of the organization because of potential of fraud. But the trust between the two organizations—and our personal trust in each other as leaders—ultimately enabled us to work out a system that we could live with." In the end, the credit union reserved a block of account numbers for new customers coming to them through AccountAbility Minnesota. At the tax site, staff provided applications with unique account numbers to customers.

In the middle of the negotiation over these important details, AccountAbility was notified the proposal to the McKnight Foundation for the three year pilot program was funded.

IMPLEMENTING THE PILOT YEAR

With the grant commitment in hand, Bonnie could post and hire a new staff member, allowing the staff expertise during the pilot phase to be institutionalized in a way that it would not if she relied upon traditional volunteers. Eva Song Margolis was hired as Program Coordinator and, as she worked with customers, Eva began to learn a lot more about their real needs and questions. A lot of the customers did not trust banks. Some had been burned before. Others had always relied heavily on alternative financial services like check cashing services. Some told stories of being turned away because of poor credit or a history of bounced checks. When Eva discussed the Express Refund Loan & Savings program, some were initially hesitant to participate, uncertain about the differences between a bank and credit union, recounting stories of abuse. Eva learned to listen carefully, communicate clearly about the product, and try to educate at every step of the way (see Appendix C).

From Bonnie's vantage point, it seemed there was the potential to make the pilot program—if successful—into a national model. But that would require taking the time to raise money for formal evaluation and marketing. Because of the growing concern about RALs nationally and the model's potential to offer a free alternative, she thought a national foundation might be interested in funding an evaluation. She called the McKnight program officer and explained the issues and potential solution. The program officer offered to make a call of introduction to the Annie E. Casey Foundation, which was interested in tax credit policy and reform. After a series of additional calls, Bonnie was invited to write a proposal to support the pilot program evaluation, requesting \$225,000 over three years. When the grant was made, she decided to contract with Children's Defense Fund, the state-wide organization already familiar with tax policy and the problems of RALs, rather than an independent evaluation firm. Together with staff from the Credit Union and Eva, they decided to track eligible customers at intake, assess

what happens after they entered the Express Refund & Savings program, and conduct a follow up survey.

New layers also continued to unfold in the relationship with the US Federal Credit Union. As Bill Raker explained, “Among some of my staff, there was skepticism because this was different than the business model we operated. We needed to do some education with our employees—what were we doing and why were we doing it to reach people not in the financial mainstream.” At the same time, clients would question whether or not AccountAbility Minnesota had any financial interest in working with the Credit Union. The nature of the free tax preparation helped to establish AccountAbility’s legitimacy but many customers had some serious questions at first. On a day- to-day basis, the difference in worldview between the Credit Union, clients, and AccountAbility was something Eva needed to navigate and manage. It was essential if this partnership was going to actually *live* and not just be an idea sitting on paper.

While the original idea for the pilot focused on the development of the no-fee loan, daily work helped to see that the larger goal was really to engage the customers in developing a sustainable relationship with a mainstream financial institution. With more electronic refunds, customers could expect fairly quick returns, even without taking out a loan. In fact, a few weeks into the tax season, it also became apparent—from the tracking being done through the evaluation—that insufficient numbers of customers were signing up for the loan product. They would never come close to making the 110 loans promised in the grant proposal. Program staff consulted with those at US Federal Credit Union and decided that four additional sites should be added—two in Minneapolis and two in St. Paul. They also began to realize that, during screening, many customers did not understand that their refund could be directly deposited into existing savings or checking accounts.

As tax season drew to a close, Bonnie was eager to see the results from the evaluation. There were some surprises in the formal report, and she discussed them extensively with her staff and US Federal Credit Union partners. While the pilot began without much sense of the demand, particularly among the targeted group (those who had previously had a RAL from a private preparer), the lack of demand was really quite surprising. Only 4% of the agency’s total customers fit the targeted profile and expressed interest—a total of only 161 people. Even among those interested, when they heard about the IRS quick turn-around time and the ease of opening Credit Union savings accounts, there didn’t seem a real need to take out a loan. In fact, only 23 customers used the Express Refund Loan program as originally envisioned. Instead, the real program success seemed to be in encouraging people to direct deposit their refunds into new or existing bank accounts; more than twice as many (54) targeted customers opened new savings accounts instead of taking loans. The pilot year suggested that an alternative strategy to issuing a loan would be to make tax refunds accessible in a timely way. Yet, the neighborhood dimension of the issue persisted; 70% of the Express Loans were given in north Minneapolis, and 61 of the new savings accounts were also started there.

As Bonnie sat down to write the first-year grant report to the McKnight Foundation, she thought hard about how to represent the experience. There were many achievements in the first year; the partnership was able to develop a loan product that was entirely free and linked to free tax assistance; participants from the first year saved an average of \$295 in fees and interest; more

taxpayers' refunds were directly deposited into a savings account. Although the original proposal stressed the number of loans to be given, she hoped the program officer would realize that the key measure of success was moving people to free tax preparation and establishing relationships with a mainstream financial institution. The organization also had continued to expand the number of clients served, both in the metro community-based sites and through Greater Minnesota partners.

News of the Express Refund Loan and Savings pilot program was shared, including articles in the two major metropolitan papers and a segment on the state's public radio news. A foundation in the western part of the state also contacted Bonnie about piloting the program there, and calls were coming from other parts of the state for presentations.

Given these results, Bonnie now needed to consider how to expand the initiative in the remaining two years.

Appendix B: Overview of Express Refund Loan & Savings Pilot program for discussion with the Board of Directors (April 2005)

Many questions need to be answered before a final process can be established with this new partnership between AccountAbility Minnesota (AAM) and the credit union. The pilot program will help define responsibilities of the community-based nonprofit and their local credit union partner. Roles of staff and volunteers from each organization will be defined and documented. Training curriculum for agency and credit union staff will need to be created and training materials developed. The pilot program will be small, serving approximately 100 low-income taxpayers the first year and it will test and develop a process that could eventually be replicated across the state. In year two of the pilot the number of taxpayers served will double to 200 and by the third year we anticipate expanding the service to parts of Greater Minnesota and hope to serve 400 taxpayers.

Although many details of the process are still to be determined, the following briefly summarizes the steps the low-income taxpayers will follow:

1. Customers come to an AAM pilot tax site for tax assistance and learn about the pilot program and free instant refunds.
2. Customers who express interest are screened for eligibility.
 - Income at or below: \$26,000 single person; \$36,000 family; \$46,000 sole proprietor, self-employed Customer used a RAL or Refund Anticipation Check (RAC) in 2004
 - Customer has a photo ID and Social Security Number
 - Customer qualifies for a savings account with US Federal
 - Customer agrees to open a savings account with US Federal for their anticipated refund deposit
3. Customers have their taxes completed and reviewed by AAM volunteers.
4. While the customer is waiting for her taxes to be done or reviewed, she meets with an AAM staff member. During this meeting the staff member explains the program procedures including that their refund will be deposited in a savings account and that the instant refund is a loan even though there are no fees or interest associated with it. Explains and gives written copy of loan disclosure, discusses incentives for saving a portion of their refund and the products available through the US Federal Credit Union or partner organization explains and, if needed, helps customer complete US Federal member application for savings account. Explains and, if needed, helps customer complete US Federal loan application.
5. Upon completion of the review of her tax return the customer signs the IRS 8453 and receives a copy of their tax return, and the originals of the credit union applications. AAM staff electronically files the tax return to the IRS and faxes a copy of the US Federal applications, customer's photo ID and Social Security card to US Federal.

6. AAM receives confirmation from the IRS within 24 hours that the customer's tax return has been accepted (or rejected) and if it is free of garnishments, such as child support or back taxes. (AAM staff calls clients that have tax returns rejected and resubmits if possible. If customer has partial garnishment AAM staff encourages direct deposit of remaining refund in client's new savings account.)
7. AAM calls US Federal to confirm acceptance of return by IRS and if refund is free of garnishments.
8. US Federal calls to inform customer that the refund amount is available in their new savings account at US Federal and they are reminded they need to visit the branch office to complete the paperwork before they can access the refund in their new account.
9. Customer visits the US Federal office closest to them to complete the loan process, learn more about savings products and receive some or all of their tax refund.