CONSEQUENCES • TAXES

IMPACT ON ALICE

What do families do when they don't have enough money to pay their taxes?

Taxes, whether they are deducted from a worker's paycheck, or paid quarterly (for self-employed workers), are a burden for ALICE families. For most workers, payroll taxes are automatically deducted from their paychecks; many have income taxes deducted regularly as well. However, many families are left with an income tax payment due each April. With low income, little or no savings, and a range of family and work responsibilities, families have limited choices for paying these taxes. Different ALICE families may try to:

▼ Seek tax credits

Tax credits make a difference for many ALICE and poverty-level households. The most common credits, the EITC and the Child Tax Credit (CTC), provide relief primarily for low-income earners with children. These credits encourage work, and they supplement the wages of low-paid workers. For taxpayers with the lowest incomes, the two credits together more than offset income and payroll taxes to raise living standards. In 2015, the two credits together lifted 9.8 million people out of poverty (including 5.1 million children), and improved financial security for an additional 22 million.[8]

EITC and ALICE
Many ALICE families, especially those without children, earn too much to be eligible for tax credits. In today's society, families with children under the age of 18 make up only one-third of households in most states. For taxpayers eligible for the EITC with no qualifying children, the credit does little to offset income and payroll taxes. As a result, these taxpayers often pay a higher rate of taxes than wealthier households.[9]

TAX CREDIT ELIGIBILITY

Many ALICE families, especially those without children, earn too much to be eligible for tax credits.

For a family with two children, the income limit for the EITC was $50,597 with a maximum credit of $5,616 in 2017. But for a single adult with no children, the income limit was $15,051, with a maximum credit of $520.[10]

Nationwide in 2017, the average EITC amount received by a total of 37 million families was $2,445, ranging from $1,957 in Vermont to $2,892 in Mississippi.[11] These amounts are significantly less than tax credits and deductions received by higher-income households (such as credits for capital losses and mortgage interest credits). For the CTC—which is more widely available across income groups—it is estimated that 91 percent of families with children received an average CTC of $2,420 in 2018.[12]

The refunds are a major boost for these families and spent immediately. Many are waiting for the refunds to pay down debt or for emergency expenses. According to a recent survey, even a one-week delay in the refund would "somewhat negatively" affect one-third of respondents' household finances. And 15 percent of families spent at least 15 percent of their refund at retail stores and restaurants within two weeks of receipt.[13]

Because the EITC makes one relatively large payment per year, it provides low-income households with a rare opportunity to make important big-ticket purchases. EITC recipients are most likely to purchase a vehicle, more so than electronics or even children's clothing.[14]

The benefit of the credit is mitigated if low-income taxpayers use a paid preparer, which 55 percent of households with income under $30,000 did in 2010. Except in a handful of states, paid preparers are not regulated, and there is wide variation in their accuracy and fees. While there are well-trained volunteer tax preparers in most states, they prepared less than 2 percent of returns.[15]

Consequences

Burden on time, attention, and cognition: ALICE and poverty-level households often miss out on tax saving opportunities. Those who are eligible for credits must be aware of them, fill out the appropriate tax forms, and submit the required documentation. For many, this is a daunting task, and particularly so for people with low English fluency or without internet access. The Internal Revenue Service (IRS) estimates that one in five people who are eligible for the EITC do not receive the credit.[16]

High rates for tax preparation: In order to receive tax credits, tax forms must be filled out correctly. Free tax preparation assistance is available through government and non-profit organizations in many locations, yet some workers either are not aware of these services or tend not to trust them. For example, according to a 2015 report to Congress, 60 percent of all Hispanic taxpayers used unregulated return preparers rather than an attorney, certified public accountant, or enrolled agent, compared to 18 percent of all U.S. taxpayers. Because unregulated preparers do not need to meet minimum standards for competency and ethics, their clients run the risk of having their returns prepared incorrectly and paying high fees.[17] In addition, many paid tax preparers charge excessive fees for additional forms, and many have an aggressive practice of charging high interest rates or fees for advancing guaranteed refunds.[18]

Minimize taxes

The rise of the gig economy means many more opportunities to earn income. While working "off-the-books" is not new, it has become much more common in the last decade with the advent of on-demand apps such as Lyft, Etsy, and Airbnb. For part-time or one-off jobs, workers may not understand their tax responsibilities. In addition, there are millions of service providers and sellers working and earning income in the "shadow economy," with income that is not readily identifiable by government tax authorities. In 2016, the U.S. shadow economy was valued at more than $1.4 trillion.[19]

Even on-the-books freelance and contract workers, whose numbers are also growing, may not be aware of their tax responsibilities or follow the current tax forms, because the classifications were developed before many of these jobs existed. While income and payroll taxes are automatically taken out of a salaried worker's paycheck, contract and freelance workers are left to make tax payments themselves, typically as estimated quarterly taxes. These workers may delay or decide against paying quarterly taxes in order to keep more of their income in the short term.[20]

Misreported individual business income and self-employment taxes make up more than 42 percent ($194 billion per year) of taxes that are unpaid or paid late.[21]

$ Consequences

Short and long term financial penalties: Late payment, nonpayment, or mistakes or misrepresentations on tax forms all carry financial penalties. When taxpayers are audited by the IRS for nonpayment or errors, they take on additional costs including hiring a skilled tax preparation professional and paying interest on taxes owed, dating from the day their return was due.[22]

Lack of financial protections in contract and freelance work: Tax avoidance in some cases may increase the appeal of contract, freelance, and cash-based work, moving more workers into arrangements that lack standard supports and protections, such as disability insurance or workplace safety regulations. These positions are also less likely to come with health and other benefits. The absence of those protections can leave workers susceptible to other problems in the future.[23]

THE HIGHT COST OF TAX ERRORS

Accidental or deliberate mistakes on tax forms can carry penalties of between 20 and 40 percent of the amount of unpaid taxes. In addition, unpaid taxes can damage one's credit score. Tax evasion, or refusal to pay taxes, is a felony carrying up to a five-year prison sentence as well as fines of up to $250,000.[24]

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