

## California Self Employment Tax Initiative 2010-2011 Final Report July 15, 2011 – Phase IV

### Summary

CAMEO conducted a fourth year of the CA SETI (original) three year demonstration project from October 2010 through June 2011. The purpose of this project was to continue to assist Micro Enterprise Development Organizations (MDOs) to reach new customers during the tax preparation process, and in this way provide needed business assistance and financing to micro business owners. Despite the fact that fewer organizations (six) participated than previous years, Phase IV of this project saw significant growth in entrepreneurs served. Participating MDO's were strategically located for geographic coverage but with a focus on the Los Angeles region; One in the Northern Region (JEDI), one in Bay Area (MEDA), and four in Los Angeles (PACE, APISBP, VEDC, and QCDC). Using a focused strategy, the MDO's attempted to penetrate the lowest income micro entrepreneurs by providing technical assistance coupled with tax preparation services at VITA sites with the goal of referring tax clients to agency services and other asset building products.

The overall goal for Phase Four was to reach 500 new or potential clients, and to file 500 Schedule C's and / or C-EZ. Unlike phases I-III, H&R Block was unable to commit funding to this project. However, CAMEO did continue its partnership with CFED with the goal to demonstrate the success of the referral model. Citi also committed funding to the project with the request that Los Angeles area and the Bay Area serving organizations participate. Therefore, the scope of the project for Phase IV differs from previous years in terms of total outreach and also scope of services delivered. However, even with fewer organizations participating, it is clear that this is a scalable model for delivering increased services and providing targeted technical assistance. As well, the services delivered were more focused. 924 Schedule C and C-EZ clients served, which yielded 554 actual new clients at the conclusion of tax season (reported 5/15/11.) VITA site participants report that 60 % of individuals who file Schedule C then access the MDO for post-tax season business training and / or access to other asset building services during the following year.

The below table shows the volume growth achieved in Phase Four, (tax year 2010).

Goals & Actuals	Potential Client Reach	Actual Client Reach*	Sch C goal	Sch C Actual	Clients obtained**
Phase I	400	116	n/a	116	54
Phase II	400	489	325	464	231
Phase III	500	881	515	834	492++
Phase IV	500	924	500	924	554++
% change III vs II	25% +	80% +	58%+	80%+	47%+
% change IV vs III	N/A	10% +	N/A	11%+	13%+

\*Phases I-III included Referrals from H&R Block. H&R Block did not participate in Phase IV.

\*\*Clients who accessed additional services provided by participating MDO

++Participating MDO's report that on average, 59% (TY 2009) of Schedule C filers access post tax season business training services. (60% reported TY 2010)

### Tax Preparation Sites – VITA TRACK

Six MDOs, Mission Economic Development Agency (MEDA) in San Francisco, Jefferson Economic Development Institute (JEDI) in Mount Shasta, Asian Pacific Islander Small Business Program (APISBP) in Los Angeles, Pacific Asian Consortium in Employment (PACE), Quantum Community Development Corp (QCDC), and Valley Economic Development Corp (VEDC) in Los Angeles provided direct tax preparation or training in tax preparation. These organizations worked with VITA sites to do the Schedule C preparation and also to direct the tax filers to additional asset building products. In partnership with CFED, CAMEO collected and consolidated a complex data set in order to gain a statewide picture of tax activity throughout California. This report was completed by all six participating MDO organizations. Key economic activity from this data is reflected in this report.

**VITA SITE: Schedule C's Filed Comparison – Tax Year 2007/08, 2008/09, 2009/10, and 2010/11**

The below table reflects the activity of all participating organizations from the inception of this project (tax year 2007) through year 4 (tax year 2010).

The growth in clients served is clearly demonstrated.

MDO	Year 1	Year 2	Year 3	Year 4	Total
API SBP	50	126	215	284	675
JEDI	28	69	74	79	250
NAAC	N/A	90	N/A	N/A	90
ABIRC	N/A	26	N/A	N/A	26
MEDA	N/A	N/A	N/A	181	181
PACE	N/A	68	64	73	205
VEDC	N/A	N/A	N/A	43	43
WEV	N/A	85	87	N/A	172
QCDC	N/A	N/A	394	264	658
<b>TOTAL</b>	<b>78</b>	<b>464</b>	<b>834</b>	<b>924</b>	<b>3300</b>

JEDI and APISBP are the sole MDO's who participated in all four years of the CA-SETI demonstration project.

For Phase IV of this project, CAMEO required each participating MDO / VITA to collect and report demographic data as well as data from 1040 and Schedule C. Key findings are outlined below:

**Demographic Data:**

60% of the self-employment (SE) clients are female, 40% male.

**Percentage of SE clients by ethnicity**

Caucasian	13%
African American	20%
Asian / Pacific Islander	29%
Latino / Hispanic	37%
Native American	0%
Other	1%

Breakdown by age cohort:

Under 25 years	4%
25-45 years	33%
46-65 years	54%
Over 65 years	8%

Breakdown by SE business net income:

Under \$5000	21%
\$5 - \$15,000	42%
\$15 – \$30,000	21%
\$30 – \$40,000	16%
\$40,001 +	3%

Schedule C Data:

Total schedule C / C-EZ filed (6 organizations reporting): 924

370 individuals (40 %, 5 organizations reporting) were returning clients who had accessed the VITA site the previous year. 115 (31%) of the returning clients *increased their AGI*.

For tax year 2009, 52% were returning SE clients who previously participated in 2008 tax preparation program (433).

Since the MDO's served more individuals overall for tax year 2010 than previous years and 40% are reported as returning clients vs 52% in previous years we speculate that these micro entrepreneurs are "outgrowing" the VITA site services (due to income limits or to increased business complexity). The positive (31%) increase in AGI of the returning clients shows that clients who access the technical assistance services available via the MDO-VITA site partnership do demonstrate positive business growth.

The five most common types of businesses that the participating MDO's serve are as follows:

1. Caregiver (elderly and childcare)
2. Housekeeper
3. Construction
4. Sales
5. Janitorial

The mission of the SETI program is to encourage business owners to formalize their businesses and to become connected to business assistance services through the CAMEO member network. In addition, SETI provides an opportunity to deliver *tax credits* to low income Self Employed households while helping with asset (business) development. Many low income individuals are unaware that they are entitled to tax credits and / or income refunds.

Key Data from Form 1040 is compiled below to illustrate the low income SE filers that were served in Phase IV.

Percentage breakdown of the SE clients by filing status (5 MDO's reporting)

Single	56%
Married (Joint)	28%
Married (Separate)	3%
Head of Household	15%
Qualifying Widow(er)	0%

368 SE clients (5 MDO's reporting) received an EITC refund, average amount \$1304.

220 SE clients (5 MDO's reporting) received a Child Tax Credit refund, average amount \$220.

539 SE clients (5 MDO's reporting) received the Making Work Pay tax credit. This is an important figure because it confirms that the client business was *profitable*.

Only 91 clients (5 MDO's reporting) had to pay a penalty. This is a significant decrease from TY 2009 when 270 SE clients (4 MDO's reporting) still owed taxes and had to pay penalties. This demonstrates the value of focused technical assistance throughout the year.

Tax year 2010 73 SE clients (5 MDO's reporting) also had W-2 income. This is a significant decrease from Tax Year 2009 (3 MDO's reporting) when 243 SE clients also had W-2 income. We speculate that the decrease in W-2 employment is a reflection of two factors: 1) The continuing anemic economy with poor job prospects; and, 2) self-employment income is increasingly more than "income patching" and is a significant (if not sole) contribution to a person's income.

## VITA Site Organizational Information - MDO Partners Year 4 – Tax year 2010

Organizational data	PACE	MEDA	JEDI	API SBP	QC DC
What percentage of your Sch C tax preparers were volunteers?	80	80	80	13	10
What percentage of your Sch C tax preparers were paid staff?	20	20	20	75	90
Does your organization or an immediate partner provide micro loans?	Yes	Yes	No	No	Yes
Does your organization provide pre-tax season business training for the SE clients during tax season?	Yes	Yes	Yes	Yes	Yes
Does your organization provide post tax season business training for the SE clients?	Yes	Yes	Yes	Yes	Yes
What % of the SE VITA site clients attend these trainings?	18%	29%	5%	n/a	40%
On average how long does it take the tax preparers to complete a Form 1040 with NO Schedule C/C-EZ	30	30	60	45	15
On average how long does it take the tax preparers to complete a Form 1040 WITH a Schedule C-EZ	60	45	75	69	30
On average how long does it take the tax preparers to complete a Form 1040 WITH a Schedule C	90	60	90	110	60
Were SE clients offered any asset building products? (ie retirement accounts, financial planning, IDA's, prepaid debit cards, business checking)	YES	YES	YES	YES	YES

Each organization either directly offers their clients asset building products (such as micro loans) or refers their clients to organizations or community partners that offer asset (including business) building products. Participating MDO's reported at 5/15/2011 that 5% of their SE clients had signed up for or opened up additional products. Since most SE tax filers file very late in the season, this figure likely does not represent the actual total. None of the organizations report micro loan activity for their tax clients but it is also the case that the preparation and packaging of a micro loan is time consuming and responses may be pending.

MDO's report highest response to the following products which were also offered.

- 1) Business Checking account
- 2) Financial Planning
- 3) Savings Bond a/o Ramp Up Savings
- 4) Pre-paid debit cards

## **VITA Site Model / Lessons Learned and Concluding Thoughts**

Participating MDO's were asked to share one story about a self-employed filer served at a VITA site that demonstrates the value and significance of filing taxes for self-employed people working to grow their business. Four client narratives from participating MDO's are below.

### **#1 MEDA**

Yolanda Dorador brought her two 1099 forms and single W2 to MEDA's tax site to file her taxes. Like many of our clients with a 1099 form, she did not know the difference between a 1099 and W2 form. She was unaware that 1099 forms are given to self-employed individuals. Yolanda earns a living by cleaning houses. Many of the self-employed tax filers are shocked by the taxes they must pay, considering the small income they made during the year. Yolanda was essentially unprepared to file her taxes because she did not have her expenses from her job itemized.

Based on similar experiences from the prior tax season, we decided to implement a workshop specifically for self-employed individuals to help them with their profit and loss statements, keeping a simplified accounting system and most importantly, explain the tax responsibilities of being self-employed. To further develop the business acumen of the self-employed individuals, we referred self-employed clients to our business development programs and other asset development services at Plaza Adelante. Yolanda attended both our business development training and financial education workshops in order to formally start her own house cleaning business. A business consultant at MEDA assisted Yolanda to register her business and develop her business plan. In addition, Yolanda was referred to Mission Asset Fund, a partner organization at Plaza Adelante, to sign up for the IDA program - with the intention of saving money to invest in her business.

### **#2 JEDI**

Studio Link and the Red Door Gallery combine a visual arts digital studio with a small art gallery for client work and frequent art shows in photography and fine art. The studio offers the latest in print technologies for fine art archival pigment (aka giclee) printing, to produce archival museum-grade prints that last for generations.

JEDI has been working with the owner of this business for several years while he struggled to get on his feet after a debilitating injury that left him incapable of finding work in the mainstream job market. He survived on little income for many years and has been battling the system for food stamps, disability payments, SSI and/or SSDI.

His tenacity and perseverance paid off in the end. Heinz was able to procure his needed equipment through the Dept. of Rehabilitation on the condition that he would be granted ownership once he could show three months of profitable sales. After reaching this milestone the equipment was transferred to him and he was able to use it for collateral to get a small loan of \$10,000.

He recently opened his business in the downtown section of Mt. Shasta and had his grand opening and first art showing on May 25<sup>th</sup> 2011.

Heinz filed his first Schedule C for 2010 showing a net profit and is on his way to becoming a successful business owner and asset to the economic community of Mt. Shasta. He has been a tax client for three years. He is a tenacious entrepreneur who has done his homework and taken advantage of every business development opportunity within his reach. His hard work has paid off with a job for himself in a field that he loves. He will be hiring a part time employee in the near future and hopes his son can be the one to help him out.

### **#3 PACE**

A mid 50 year old lady moved to Los Angeles from Chicago after her husband left her for his secretary. She came to our site to file her taxes for the very first time in her life. She had started a business last August to host shoe parties, selling shoes she purchased wholesale from the LA fashion district.

When she first came to the site we were unable to serve her because she hadn't confirmed that she was a business owner and did not bring any records. Our intaker provided her with a sample cash flow worksheet and advised her to schedule an appointment after completing the form with relevant documentation. A week later, we received a concerned phone call from her that she had never done this before and was about to have a nervous breakdown. I scheduled a one-on-one counseling session and walked her through the entire business expenses along with cash flow projection / worksheet which took over three hours.

After completing her very first tax return, she was pleasantly surprised with a \$358 refund. She did not know that the government would give money back to tax payers. She has now become a regular client having completed the Small Business Tax and Credit Workshop. She will attend Quickbooks training and entrepreneur training class in 2011.

### **#4 QCDC**

For the past five years Janice has been one of our highly valued clients. She has consistently utilized our tax preparation and small business technical assistance services. In the later part of 2009, Janice experienced hardship as a result of the current economic downturn. She lost 85-95% of her income

which was primarily business income. While dealing with family and financial issues, Janice decided not to file her tax returns for a couple of years. During this time, she put her entrepreneurial dreams on hold.

In 2011, she has been motivated to get back to her business. She has re-organized and re-focused her business efforts. She quickly realized that in order to receive financial assistance and additional resources she need to file her overdue tax returns. She recognizes that filing her business tax returns is not just about complying with governmental regulations; it is also about taking care of her business in a financially prudent manner. The fact that she has to file her taxes forces her to be financially accountable to her own business which also allows her to better plan and expand her business. She has made a vow to herself and to Quantum CDC that she will file her taxes on time from this point forward. The success of her business depends on it!

CAMEO strongly supports the MDO / VITA site partnership model as a scalable program delivery strategy. Self-employment tax season is a “magic” moment and local MDO’s are eager to provide this service. Institutional obstacles with the IRS remain. Some organizations are restricted in the types of businesses they can serve (ie businesses with inventory, business loss, employees, and property). MDO’s should view business tax preparation as part of their scope of services to low and moderate income business owners and should consider investing in staff training that will support this capacity building objective.

As the above data suggests, the conversion rate from VITA site clients to ongoing MDO client is quite strong (60%). In addition, the MDO’s are reporting not only increased clients and service delivery, but increased business revenues for returning clients. Clients are also taking advantage of other Asset Building products that will support their business growth.

MDO’s should be encouraged to develop business tax preparation services as part of their program delivery and also take the opportunity to partner with other organizations (corporate and non-profit) to offer additional asset-building products (ie, retirement accounts, IDA’s, business checking accounts, micro loans, etc)

## Conclusion

CAMEO is satisfied with the primary outcomes achieved by this 4-year demonstration project.

1. Significant numbers of new low income micro business clients were served by MDOs offering Schedule C tax preparation services.
2. 60% of Individuals who filed Schedule C via VITA site, then accessed business services at the MDO partner.
3. 60% of Schedule C filers are new filers, thus demonstrating that outreach is effective in formalizing self-employment so that business owners contribute to Social Security.
4. Client businesses appear to be increasing their income: 31% of returning Schedule C clients increased their AGI. 58% of clients obtained the Making Work Tax Credit; 7% are “patching” family income through both self-employment and wages.

CAMEO intends to continue to partner with CFED on the advocacy efforts with the IRS and also continue to promote the SETI model as a viable marketing opportunity to MDO's not only in California but nationally. CFED's advocacy efforts have begun to pay off and for tax year 2010 the IRS officially allowed Schedule C's to be prepared at select VITA sites. To date (to our knowledge) California VITA sites are not among those officially sanctioned by the IRS; however, certain sites were able to obtain spec approval while other sites were hampered by not being able to serve all businesses. The task for CA-SETI is to continue to demonstrate a successful model and support CFED's advocacy work with the IRS to increase the scope of the VITA program in California to include Schedule C. Informal and Self-Employed income is broad and far reaching in the California and if the IRS wants their “part” of it, it is imperative that the scope of the free tax preparation is broadened. It feels contradictory to exclude Schedule C filers from the free service as they are often as much in need of it as seniors or taxpayers in the \$40,000 + AGI income bracket.

CAMEO wishes to thank Citi and CFED for their support of this innovative project.