

Table 1: Percent of EITC and Non-EITC Returns with RALs and Dollars Lost

The 25 Counties with the Highest Percentage of EITC Filers Taking Out RALs (Refund Anticipation Loans), Tax Year 2003 and Select Cities

	Number of EITC Returns	Percent of All Returns with EITC	Percent of EITC Returns with RAL*	Percent of Non-EITC Returns with RAL*	Dollars Lost to Tax Preparation	Dollars Lost to Purchasing a RAL	Total Dollars Lost to Tax Prep and RAL	Child Poverty Rate
<b>Highest RAL Counties</b>								
Todd, SD	1,689	59.7%	67.7%	22.0%	\$185,040	\$147,714	\$332,754	57.7%
Tunica, MS	2,778	55.6	66.8	20.0	298,800	239,407	538,207	44.1
Shannon, SD	2,133	60.8	66.5	34.3	233,160	183,502	416,662	61
Washington, MS	10,693	48.1	65.6	14.9	867,600	900,904	1,768,504	38.5
Sharkey, MS	1,226	54.5	65.6	11.6	59,520	103,271	162,791	50.4
Kenedy, TX	74	47.1	65.3	14.6	6,840	6,199	13,039	n/a
Lake, TN	753	33.5	65.1	16.0	76,440	62,103	138,543	35.7
Jefferson, GA	3,087	41.4	65.0	14.6	307,320	258,003	565,323	29.3
Yazoo, MS	4,332	44.5	65.0	13.7	376,440	360,572	737,012	43.1
Scotland, NC	4,879	35.6	64.6	15.0	498,360	403,846	902,206	30.3
Terrell, GA	1,945	46.4	64.4	14.2	187,320	161,281	348,601	41.1
Stewart, GA	880	44.0	64.4	14.3	85,680	73,097	158,777	30.5
Randolph, GA	1,320	46.1	64.0	11.3	73,440	108,066	181,506	36.3
Buffalo, SD	309	56.4	63.8	23.1	27,360	25,379	52,739	61.8
Dillon, SC	5,226	42.5	63.7	17.2	481,800	425,365	907,165	33.4
Emporia, VA	1,859	33.1	63.4	14.7	170,760	150,755	321,515	21.9
Crisp, GA	3,219	39.4	63.3	11.9	321,600	260,342	581,942	41.9
Allendale, SC	1,865	50.4	63.1	18.3	188,520	150,755	339,275	48.1
Scott, MS	4,624	40.4	63.0	13.6	451,560	368,876	820,436	27.5
Claiborne, MS	1,754	51.2	62.8	16.5	157,920	141,516	299,436	40.8
Benson, ND	969	36.6	62.7	12.7	101,400	75,670	177,070	39.2
Marlboro, SC	4,931	42.8	62.7	18.8	477,480	397,296	874,776	29.4
Clay, MS	2,934	37.7	62.7	15.4	273,360	235,547	508,907	34.4
Thurston, NE	1,023	38.3	62.7	17.3	110,760	80,699	191,459	33.1
Issaquena, MS	194	56.9	62.6	18.2	9,840	15,789	25,629	43.2
<b>Largest Cities**</b>								
New York, NY	806,214	24.4	23.9	6.4	72,297,360	22,844,820	95,142,180	30.3
Los Angeles, CA	244,349	28.2	25.6	6.5	23,773,800	7,462,197	31,235,997	30.7
Chicago, IL	279,511	24.9	41.3	9.6	24,553,440	14,248,862	38,802,302	28.5
Houston, TX	273,576	25.5	42.5	11.1	24,743,040	14,385,348	39,128,388	26.4
Philadelphia, PA	158,555	26.8	37.1	7.9	12,010,920	7,451,203	19,462,123	31.6
Phoenix, AZ	94,333	20.5	34.0	8.3	8,162,400	4,029,801	12,192,201	21.5
San Diego, CA	72,616	13.7	20.3	5.6	6,249,840	1,780,289	8,030,129	20.3
San Antonio, TX	154,187	26.2	43.0	9.5	12,423,600	8,373,510	20,797,110	24.6
Dallas, TX	121,783	24.4	46.9	11.7	11,109,600	7,167,938	18,277,538	25.5
San Jose, CA	41,046	10.7	13.4	4.7	3,685,200	658,924	4,344,124	10.9
<b>U.S. Totals</b>	<b>21.4 million</b>	<b>16.9%</b>	<b>34.2%</b>	<b>5.1%</b>	<b>\$1.8 billion</b>	<b>\$909 million</b>	<b>\$2.7 billion</b>	<b>16.6%</b>

\* Of returns with a refund

\*\* Largest U.S. cities as of July 2004. Population Division, U.S. Census Bureau.

## Endnotes

<sup>1</sup> IRS SPEC Return Information Data Base, Tax Year 2003 (October 2005). Calculations by CDF.

<sup>2</sup> Robert Greenstein, "The Earned Income Tax Credit: Boosting Employment, Aiding the Working Poor," Center on Budget and Policy Priorities, August 17, 2005. Retrieved from <http://www.cbpp.org/7-19-05eic.htm>.

<sup>3</sup> H&R Bloc, Q4 2002 H&R Block Earnings Release Conference Call, June 12, 2002, available at 2002 WL 26337229. Cited in Wu, Chi Chi and Jean Anne Fox, "All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low Income Americans," NCLC/CFA 2004 Refund Anticipation Loan Report, January 2004, page 5. Retrieved from <http://www.consumerfed.org/pdfs/RefundAnticipationLoanReport.pdf>.

<sup>4</sup> These values are based on all EITC claimants who receive a refund.

<sup>5</sup> IRS SPEC Return Information Data Base, Tax Year 2003 (October 2005). Calculations by CDF.

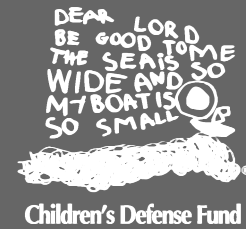
<sup>6</sup> IRS Publication 2043. Based on this publication, the IRS direct deposits refunds in 8 to 15 days. APR calculations are based on a 10-day loan period and are based on the full RAL cost, including all fees and surcharges.

<sup>7</sup> IRS SPEC Return Information Data Base, Tax Year 2003 (October 2005). Calculations by CDF.

<sup>8</sup> National Taxpayer Advocate 2005 Annual Report to Congress, Criminal Investigation Refund Freeze Study, December 31, 2005. Retrieved from [http://www.irs.gov/pub/irs-utl/section\\_4.pdf](http://www.irs.gov/pub/irs-utl/section_4.pdf).

<sup>9</sup> U.S. Census Bureau, 2000 Census. Calculations by CDF.

<sup>10</sup> A. Berube, A. Kim, B. Forman, and M. Burnes, "The Price of Paying Taxes," The Brookings Institution, May 2002. Retrieved from <http://www.brookings.edu/dybdocroot/es/urban/publications/berubekimeitc.pdf>.



## The Children's Defense Fund

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## Keeping What They've Earned: Tax Credits for Working Families

More than 13 million children live in poverty in the United States. Across the country this tax season, millions of their low- to moderate-income families will receive tax refunds through the Earned Income Tax Credit (EITC) program—one of the most effective federal weapons against poverty. More than 21.4 million taxpayers claimed over \$38.3 billion in 2003. The EITC not only helps to alleviate poverty among working families, it also boosts local economies since refunds are often used to pay for rent, utilities, food and child care. Unfortunately, up to 20 percent of eligible low-income taxpayers do not claim the EITC, while others claim the credit but pay exorbitant fees to have their taxes prepared or to receive their refund more quickly. Millions of dollars are lost to families and communities nationwide through Refund Anticipation Loans (RALs), high-interest loans that tax filers take out against their expected tax refunds, commonly marketed as "Rapid Refunds" or "Fast Money." Approximately 70 percent of families claiming the EITC use commercial tax preparers, unaware of other choices available to them—including free tax preparation at Volunteer Income Tax Assistance (VITA) sites.

EITC-eligible families lost an estimated \$2.7 billion to tax preparation and high-interest loans during the 2003 tax year.<sup>1</sup> Much more needs to be done on the national, state, and local levels to ensure that EITC dollars make it into the pockets of the needy recipients who the program was designed to help.

### Earned Tax Credits for Working Families

The EITC has wide bipartisan support and has been a part of the federal tax system since 1975. It is the most effective work support tool to assist families who work full- or part-time but earn low wages. EITC refunds received for the 2003 tax year helped to lift 4.4 million people, including 2.4 million children, out of poverty.<sup>2</sup> Recipients can use the credit to help pay income taxes owed or, in most cases, even get money back in the form of a refund.

The EITC means real money in the pockets of eligible individuals and families. For the 2005 tax year, the EITC is worth up to \$4,400 for workers who earned less than \$35,263 (\$37,263 if married and filing jointly) and have two or more qualifying children. Workers earning less than \$31,030 (\$33,030 if married and filing jointly) with one qualifying child may be eligible for up to \$2,662. Working adults between the ages of 25 and 64 with no children, who earned less than \$11,750 (\$13,750 if married and filing jointly) may also qualify for an EITC worth up to \$399.

In addition, many EITC recipients are also eligible for other tax credits such as the Child Tax Credit (CTC). The Child Tax Credit is a federal tax credit for working families with children and incomes above \$11,000 that may be worth up to \$1,000 for each child claimed in 2005. In 2003, the average total refund for taxpayers claiming the EITC who also received other tax credits was \$2,782.

### Costs of Using Commercial Tax Preparers and Refund Anticipation Loans (RALs)

To claim the EITC and other tax credits for which they are eligible, taxpayers need to complete and file their federal and state income taxes—a task that can be quite complex since tax laws, especially those regarding the EITC, are very complicated and often change from one year to the next. In addition, many low-income families face language and literacy barriers. Consequently, it is not surprising that more than 70 percent of low-income families eligible for the EITC hire commercial tax preparers to do their tax returns. It is estimated that these recipients spend an average of \$120 to have their taxes prepared and electronically filed.<sup>3</sup> For EITC families living paycheck to paycheck, this is a significant amount of money—nearly five percent of their total refund.<sup>4</sup> Nationwide, tax preparation costs represent about \$1.8 billion lost to poor working families.<sup>5</sup>





Children's Defense Fund

The Children's Defense Fund® (CDF) mission is to Leave No Child Behind and to ensure every child a Healthy Start, a Head Start, a Fair Start, a Safe Start, and a Moral Start in life and successful passage to adulthood with the help of caring families and communities. The Children's Defense Fund's national Tax and Benefits Outreach Initiative is entering its third year of working with coalitions across the country during the tax season. CDF has partnered with organizations in local community coalitions to run Volunteer Income Tax Assistance (VITA) sites and provide outreach to working families. These partnerships have resulted in helping families and local communities get an estimated \$170 million in tax refunds during the past two years.

## The Children's Defense Fund



**A 29-year-old security guard at a workforce development center in Jackson, Mississippi, received a \$4,500 Refund Anticipation Loan (RAL) from a commercial tax preparer. When he received the RAL, he mistakenly thought it was his tax refund check. The Internal Revenue Service found a problem with his tax return, however, and he had no means to repay the RAL. A bank officer continually called him regarding payment of the loan, and the bank eventually sent the loan to a collections agency. He went to a local Volunteer Income Tax Assistance (VITA) site at Hope Community Credit Union in Jackson where he was introduced to an attorney and accountant, both working pro bono, who helped him correct the tax return error and settle and pay the RAL. He then opened his first ever savings and checking accounts with Hope Community Credit Union, where he proudly deposited his tax refund into his new accounts and began saving for the future.**

In addition to paying high fees to commercial tax preparers, many working families also use Refund Anticipation Loans, or RALs, to get their refund money on the same day or within a few days. These short-term, high-interest loans are based on the filer's expected tax refund and can end up costing the client a large percentage of their refund. The average EITC family purchasing a RAL paid \$130—equal to a loan with an Annual Percentage Rate (APR) of about 179 percent<sup>6</sup>—just to get their refund one or two weeks sooner. This means needy families lose an additional \$909 million in RAL fees.<sup>7</sup> When tax preparation fees are included, the typical family getting a RAL loses nearly five percent of its federal refund. Between \$1.8 billion in tax preparation fees and an additional \$909 million in RAL fees, working families, and their communities, are deprived of \$2.7 billion nationwide.

In most cases, RALs are paid off once the Internal Revenue Service (IRS) processes the tax return and transfers the funds. But RAL loans can actually place families at greater financial risk since they are responsible for paying the interest accruing on the loan if the IRS denies part of the refund for any reason or even withholds it temporarily for audit purposes. According to a recent study by the National Taxpayer Advocate, nearly 75 percent of the tax returns frozen by the IRS because of suspected fraud belonged to low-income taxpayers claiming the EITC, although well over half of all frozen refunds (56-66 percent) were ultimately found to be free of fraud.<sup>8</sup> Given their often pressing financial needs, it is unlikely that EITC families budget for this possibility. There is also ample anecdotal evidence showing some families, especially those with limited English proficiency, do not fully comprehend that they are taking out a loan. Families could actually *end up in debt* due to their efforts to claim EITC and other tax benefits intended to assist them in becoming more financially secure.

One of the largest commercial tax preparers, H&R Block, is awaiting final federal approval on a proposed settlement to four state class action lawsuits and potential claims involving its use of RALs in 22 other states and the District of Columbia. Other lawsuits, including a national class action, are still pending. Although H&R Block has made an effort to resolve its use of RALs, there are still many other commercial tax preparers, both large companies and small store front operations, that continue to market Refund Anticipation Loans.

### Use of RALs in the United States

RAL vendors continue to target EITC families. According to IRS data, 34.2 percent of EITC tax filers receiving refunds for 2003 also took out RALs, whereas only 5.1 percent of non-EITC taxpayers who received a refund got RALs for the same year.

As Table 1 indicates, counties with high rates of RAL usage also tend to have much higher rates of poverty than the national average. The child poverty rate in the 25 U.S. counties in which the highest percentage of EITC families purchased RALs was 38 percent, more than twice the national rate of 16.6 percent.<sup>9</sup> In fact, research indicates that commercial tax preparers target low-income neighborhoods for their services. Neighborhoods with high percentages of EITC filers have 50 percent more electronic tax filing and preparation services than those with low percentages of EITC filers.<sup>10</sup>

### Recommendations

**1. Strengthen consumer protection and education.** Currently, there is little regulation of commercial tax preparers—nearly anyone can hang a “tax preparer” shingle, regardless of education or knowledge of ever-changing tax laws. The federal and state governments must do more to regulate and monitor the practices of commercial preparers as well as their partner banks, including:

- Licensing all commercial tax preparers.
- Requiring all RAL brokers to prominently display not only all associated fees and interest rates, but to also inform customers that they could receive their full refund in one to two weeks from the IRS through e-filing and direct deposit without paying for a RAL.

- Prohibiting RALs to be used with EITC refunds; or placing a cap on interest rates that banks can charge for RALs.

Federal legislation has been proposed that addresses the issues of the Earned Income Tax Credit and RALs. The Taxpayer Protection and Assistance Act (S.832) would increase funds to sites that offer free tax preparation for low- to moderate-income families; require those selling RALs to register with the IRS; and provide oral disclosure to taxpayers regarding loan fees and interest rates.

- 2. Expand access to free tax assistance.** Although free tax assistance for low-income families is available at Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), AARP, and other preparation sites in many communities nationwide, less than two percent of EITC-eligible taxpayers use them. Federal, state, and local governments should partner with employers, foundations, churches, and other community groups to provide financial assistance, make site locations available, donate computers for electronic filing, help recruit volunteers, and conduct outreach with potential EITC families. These preparation sites, along with free or low-cost filing Web sites offered by the IRS and other organizations, should be better promoted to working families. Throughout the United States, CDF state and regional offices operate VITA sites and work with other organizations and federal and state agencies to provide and promote free tax assistance.
- 3. Simplify the rules and process.** Federal and state laws that govern working families' income taxes need to be simplified, and federal and state tax credit programs should be coordinated, so working families can complete their own taxes without having to pay for professional assistance.
- 4. Connect families with financial services and help them develop financial literacy.** Having a tax refund electronically deposited directly into a bank account speeds up the turnaround time significantly, but one out of four families with incomes less than \$25,000 does not have a bank account. Connecting families with banks and credit unions offering free or very low-cost bank accounts can make a tremendous difference; and recent efforts by financial institutions to offer free tax assistance and financial literacy are proving successful.
- 5. Create a state EITC.** Most poor children live in families with a working parent, and the creation of a state EITC could supplement wages and help to lift a family out of poverty. Nineteen states including the District of Columbia have enacted a state EITC worth some percentage of the federal credit. Research indicates that tax refunds, including state EITC refunds, can be used to help families build assets while stimulating local economies.

### Conclusion

Throughout the country, hard-working taxpayers lost an estimated \$2.7 billion in large fees to commercial tax preparers and “rapid refund” vendors in tax year 2003—money that could have been used to help lift children and families out of poverty and boost local economies. Much more can and should be done on the local, state, and national levels to ensure that EITC dollars make it into the pockets of working families. The Children's Defense Fund's efforts to educate and assist families are making a difference in the lives of working families. Only when every eligible working family has access to free and fair tax preparation services can we truly *Leave No Child Behind*.

