



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

Ann<sup>1</sup>, a single mother, has visited a local tax preparer that specializes in Refund Anticipation Loans (RALs) these past few years. This tax season, she paid over \$400 in tax preparation and Refund Anticipation Loan fees. She was told that her check of over \$5,000 would be available within two weeks. Despite this promise, Ann has not received her check and was recently informed by the IRS that she owes over \$2,000 in back taxes. This experience has left her feeling angry. She has since learned about the free tax preparation services offered at Volunteer Income Tax Assistance (VITA) sites. Also, she has learned that she can get her refund check within 10-14 business days by e-filing and getting direct deposit in her bank account without taking out a Refund Anticipation Loan. She vows to get her taxes prepared at the local VITA site in the years ahead.

Ann's story, though troubling, is not atypical. Throughout the country this tax season, millions of working families will claim billions of dollars in EITC refunds. A large percentage of these taxpayers will pay outrageous fees to have their taxes prepared and to receive their refund more quickly. According to data from the Internal Revenue Service (IRS), recent success in promoting the EITC has been accompanied by losses to commercial tax preparers and RAL lenders:

- More than 21.7 million taxpayers received the EITC in 2004, representing a \$39.8 billion investment in children, families, and the communities in which they live, work, and play. Tax preparation fees and RALs drained nearly \$2.9 billion from this investment.<sup>2</sup>
- In Mississippi, over 367,000 taxpayers claimed an estimated \$788 million in Earned Income Tax Credits. These EITC claims composed roughly two percent of the national total, but Mississippians lost an estimated \$57.2 million to preparation fees and high interest loans.

### Support for Working Families

Each year, the EITC lifts nearly 5 million Americans above the poverty line.<sup>3</sup> Its contribution to the well-being of lower-wage, working families is significant—giving working parents an opportunity to support their families and infusing money into the local economy.<sup>4</sup> For tax year 2006, this federal tax credit is worth up to:

- \$4,536 for families with two or more children;
- \$2,747 for families with one child; and,
- \$412 for individuals between the ages of 25 and 64 with no children.

In addition, many EITC recipients are also eligible for other tax credits such as the Child Tax Credit (CTC). The CTC is a federal tax credit for working families with children and incomes above \$11,300 and it is worth up to \$1,000 for each child claimed. In

2004, the average total refund for Mississippi taxpayers claiming the EITC who also received other tax credits was \$3,251.

### Costs of Using Commercial Tax Preparers and Refund Anticipation Loans

In order to claim the EITC and CTC, taxpayers must file their federal and state tax returns. This task can be quite challenging, as large numbers of EITC-eligible families hire commercial preparers to complete their returns. In 2004, over 73 percent paid to have their return completed professionally. Tax preparation fees drained nearly \$40.2 million from the pockets of working families.

In addition to paying high fees to commercial tax preparers, many working families also use Refund Anticipation Loans to get their refund money more quickly. These short-term, high-interest loans are based on the filer's expected tax refund and can end up costing a taxpayer a large percentage of what they are owed. In 2004, the average family in Mississippi purchasing a RAL paid \$100 just to get their refund one or two weeks sooner—meaning that hard-working families lost \$16.9 million to RAL fees. What's more troubling is that EITC recipients are about five times as likely to purchase a RAL than taxpayers who did not file for the credit. According to IRS data, almost 169,000—or 47 percent—of Mississippi's EITC tax filers receiving refunds for 2004 also took out RALs, whereas only 9.5 percent of non-EITC taxpayers who received refunds purchased RALs for the same year. Figure 1 illustrates the disproportionate usage of RALs by EITC families

Figure 1: EITC v. Non-EITC Filers who Purchased Refund Anticipation Loans (RALs)

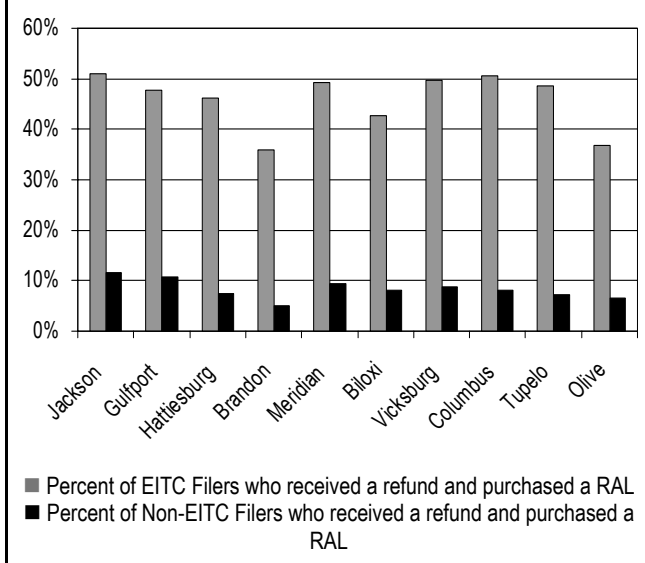


Figure 2: Total Dollars Lost to Tax Preparation and the Purchase of RALs in Cities with the Highest Total Number of Returns Filed, Tax Year 2004

City	Total Returns	EITC Returns	% of EITC Filers who used Paid Preparers	% of EITC Returns with a RAL*	% of Non-EITC Returns with a RAL*	Dollars Lost to Tax Prep and RALs**	Child Poverty Rate
Jackson	73,020	29,924	58.4%	51.0%	11.7%	\$4,128,720	34.0%
Gulfport	33,497	10,166	72.8%	47.8%	10.7%	\$1,584,930	26.2%
Hattiesburg	29,178	8,577	74.8%	46.1%	7.4%	\$1,349,850	36.6%
Brandon	25,959	3,583	65.1%	36.0%	5.0%	\$474,390	7.7%
Meridian	25,361	8,198	82.8%	49.3%	9.4%	\$1,415,370	40.8%
Biloxi	25,041	5,959	68.3%	42.6%	8.0%	\$856,500	20.1%
Vicksburg	20,751	6,894	58.4%	49.8%	8.8%	\$942,090	35.1%
Columbus	19,995	6,361	60.2%	50.5%	8.0%	\$890,760	41.0%
Tupelo	18,376	4,857	77.8%	48.7%	7.2%	\$798,630	17.7%
Olive Branch	16,674	2,303	71.1%	36.8%	6.5%	\$327,360	7.4%
Mississippi Totals	1,132,124	367,122	73.2%	47.0%	9.5%	\$57,155,220	27.0%
US Totals	128,599,631	21,721,218	70.6%	28.8%	4.5%	\$2,896,229,700	16.6%

Source: Internal Revenue Service SPEC Information Database, Tax Year 2004 (December 2006). Poverty figures from US Census Bureau 2000 Census. CDF calculations.

\*Of those who received a refund

\*\*Calculated based on a \$150 average tax preparation fee and a \$100 average RAL fee.

in the state's largest cities. Between the costs of tax preparation and RAL fees, the typical EITC family in Mississippi getting a RAL loses an estimated 4.9 percent of its federal refund.

Although RAL usage dropped significantly in 2004, new industry developments put lower-wage families at greater financial risk.<sup>5</sup> Vendors introduced the pay stub or holiday RAL, which is available to taxpayers prior to receiving their W-2s and is taken out against their expected return. As advocates educate taxpayers about the dangers of purchasing RALs, lenders are finding more ways to reach taxpayers earlier. These developments hurt community efforts to encourage the use of free tax filing sites because loans are now accessible before the tax season begins. To complicate matters, some preparation businesses require pay stub and holiday RAL users to return to the same office once more to have their tax returns completed.<sup>6</sup>

#### *Effects on Economic Activity*

RAL fees and tax preparation costs represent a significant drain on local economies across Mississippi. Figure 2 summarizes the total dollars lost in Mississippi's largest cities while Figures 3 and 4 highlight the losses endured at the county level. Of note, nine of the top 25 counties in the state with the highest percentage of RAL purchases are located in the Mississippi Delta region. More disturbing, Yazoo, Marion, Jasper, and Washington counties are ranked among the top 25 counties in the nation of percentage of RAL purchases among EITC claimants.

In addition, these figures reveal that counties with high rates of RAL usage also tend to have higher rates of child poverty than the national average. The average child poverty rate in Mississippi's 10 counties with the highest percentage of RALs was 36.6 percent, significantly higher than the state-wide rate of 27.0 as well as the national rate of 16.6 percent.

While only a handful of studies have measured the economic impact of the Earned Income Tax Credit on local economies, their results are telling. An analysis of EITC population and participation rates by researchers in San Antonio concluded that increasing the number of EITC claims would benefit the city's economy. Not only would two-thirds of additional EITC dollars be spent locally on retail, general services and utilities, but each additional dollar received would generate roughly \$1.58 in local economic activity.<sup>7</sup> Unfortunately, cities such as San Antonio do not benefit fully from increasing EITC participation rates because money that was intended for working families is diverted into the portfolios of commercial tax preparers and lending institutions. Mississippi communities are similarly affected because fewer dollars in the hands of working families means less economic activity.

#### *Recommendations*

Mississippi families lost an estimated \$57.2 million because of tax preparation fees and RALs in 2004. Government officials and community leaders are in a unique position to develop public policies that address the cause and mitigate the effect of RALs and costly tax preparation on lower-income communities. To that end, Children's Defense Fund—SRO recommends:

1. ***Strengthen consumer protections.*** Mississippi lawmakers must consider adopting policies that establish licensing requirements for commercial tax preparers, ensure full disclosure of RAL fees and interest rates, prohibit the sale of RALs to EITC recipients, and place a cap on the interest rates that banks can charge for RALs. In January 2007, House Bills 375 and 751 were introduced by Representatives Guice and Upshaw, respectively, and sent to the Banking and Financial Services committee. These bills would require tax preparers to disclose information about Refund

Figure 3: Total Dollars Lost to Tax Preparation and RALs in Mississippi Counties with the Highest Number of Total Returns Filed, Tax Year 2004

County	Total Returns	EITC Returns	% of EITC Filers who used Paid Preparers	% of EITC Returns with a RAL*	% of Non-EITC Returns with a RAL*	Dollars Lost to Tax Prep and RALs**	Child Poverty Rate
Hinds	102,536	36,588	58.3%	49.1%	10.1%	\$4,970,250	28.9%
Harrison	79,762	21,386	70.8%	43.8%	9.3%	\$3,183,870	21.2%
De Soto	57,627	10,731	72.1%	39.6%	8.2%	\$1,572,600	8.6%
Rankin	53,017	9,758	64.3%	38.9%	7.2%	\$1,308,000	12.6%
Jackson	50,606	12,785	72.5%	42.0%	8.3%	\$1,911,270	18.2%
Forrest	37,446	10,737	73.8%	44.8%	7.6%	\$1,656,810	28.8%
Lee	35,592	9,961	78.4%	47.4%	8.3%	\$1,633,710	18.2%
Madison	35,278	8,250	51.0%	46.1%	6.2%	\$1,003,410	21.4%
Lauderdale	31,821	10,088	82.7%	49.0%	9.4%	\$1,738,350	29.0%
Jones	23,476	7,530	77.1%	49.9%	9.25%	\$1,236,990	25.5%
Lowndes	22,134	7,234	60.6%	50.9%	8.4%	\$1,020,210	31.9%
Washington	22,013	10,578	79.0%	55.6%	12.3%	\$1,836,000	38.5%
Warren	21,052	6,983	58.3%	49.8%	8.9%	\$953,220	28.0%
Pearl River	19,397	5,548	74.8%	37.4%	9.3%	\$819,030	26.0%
Pike	16,102	6,590	68.2%	48.9%	9.8%	\$990,720	35.8%
Marshall	15,818	5,882	84.7%	49.3%	14.2%	\$1,030,080	28.7%
Monroe	15,394	4,866	82.7%	52.7%	13.6%	\$853,410	22.5%
Panola	14,791	6,037	76.8%	48.3%	10.6%	\$981,600	33.2%
Oktibbeha	14,515	4,164	70.7%	52.7%	8.3%	\$657,750	30.7%
Lafayette	14,010	3,138	75.7%	35.9%	4.0%	\$465,120	16.0%
Bolivar	13,892	6,382	80.9%	40.9%	8.2%	\$1,032,000	44.0%
Hancock	13,877	3,460	71.2%	34.6%	5.9%	\$483,720	18.4%
Alcorn	13,371	3,584	86.6%	50.2%	12.4%	\$639,180	19.1%
Neshoba	12,747	4,289	84.2%	50.4%	12.6%	\$754,020	27.7%
Adams	12,680	4,825	82.5%	35.5%	7.1%	\$765,120	36.8%
Mississippi Totals	1,132,124	367,122	73.2%	47.0%	9.5%	\$57,155,220	27.0%
US Totals	128,599,631	21,721,218	70.6%	28.8%	4.5%	\$2,896,229,700	16.6%

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Anticipation Loans to clients and place restrictions on the fees that tax preparers could charge for RALs.

2. **Expand access to free tax assistance.** Large numbers of Mississippians pay to have their taxes completed and filed. Elected officials and community leaders must find ways to build and maintain free tax preparation networks throughout the state by investing in the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs and other free tax assistance centers.
3. **Connect working families to mainstream financial services.** Free or low-cost checking and savings accounts, credit counseling opportunities, and financial education programs offer working families the tools to

build for a better financial future, and public – private partnerships should be explored and established to ensure that working families have easy access to these resources.

4. **Create a state EITC.** Mississippi does not have a state Earned Income Tax Credit. Research indicates that tax refunds, including a state EITC refund, can be used to help families build assets while stimulating local economies. In January 2007, House Bills 1567, 1577, and 1595 were introduced by Representatives Fleming, Watson, and Franks, respectively, and sent to Ways and Means. These bills would provide for a state EITC at a percentage of the federal EITC.

Figure 4: Mississippi Counties with the Highest Percentage of Refund Anticipation Loan Purchases, Tax Year 2004

County	Total Returns	EITC Returns	% of EITC Filers who used Paid Preparers	% of EITC Returns with a RAL*	% of Non-EITC Returns with a RAL*	Dollars Lost to Tax Prep and RALs**	Child Poverty Rate
Yazoo	9,539	4,200	71.2%	61.4%	12.0%	\$702,240	43.1%
Marion	9,852	3,713	73.7%	56.1%	15.6%	\$611,820	32.6%
Jasper	7,282	2,961	79.7%	55.8%	12.4%	\$516,120	28.9%
Washington	22,013	10,578	79.0%	55.6%	12.3%	\$1,836,000	38.5%
Holmes	8,103	4,514	53.0%	55.0%	15.1%	\$604,020	52.4%
Scott	11,358	4,634	79.1%	54.6%	12.8%	\$797,100	27.5%
Noxubee	4,540	2,300	75.9%	54.4%	16.5%	\$384,420	43.7%
Sharkey	2,202	1,205	38.4%	52.9%	9.3%	\$132,540	50.4%
Simpson	10,209	3,622	81.0%	52.7%	12.7%	\$626,670	26.0%
Monroe	15,394	4,866	82.7%	52.7%	13.6%	\$853,410	22.5%
Oktibbeha	14,515	4,164	70.7%	52.7%	8.3%	\$657,750	30.7%
Tallahatchie	4,825	2,675	79.7%	52.6%	10.9%	\$457,890	43.8%
Benton	2,491	941	87.7%	52.2%	14.6%	\$171,900	28.1%
Clay	7,569	2,896	77.7%	51.4%	12.9%	\$483,870	34.4%
Leflore	12,282	5,858	65.6%	51.3%	8.4%	\$873,660	48.2%
Issaquena	344	190	41.1%	51.0%	14.9%	\$21,240	43.2%
Covington	7,715	2,962	77.1%	51.0%	12.1%	\$489,960	31.7%
Lowndes	22,134	7,234	60.6%	50.9%	8.4%	\$1,020,210	31.9%
Clarke	6,704	2,352	82.4%	50.8%	10.4%	\$407,460	32.6%
Neshoba	12,747	4,289	84.2%	50.4%	12.6%	\$754,020	27.7%
Prentiss	7,858	2,130	85.3%	50.3%	11.6%	\$375,330	19.1%
Alcorn	13,371	3,584	86.6%	50.2%	12.4%	\$639,180	19.1%
Kemper	3,445	1,491	86.7%	50.1%	10.8%	\$267,330	35.4%
Tunica	5,026	2,764	89.0%	50.0%	12.6%	\$505,830	44.1%
Sunflower	9,841	5,432	66.1%	49.9%	10.4%	\$806,850	39.8%
Mississippi Totals	1,132,124	367,122	73.2%	47.0%	9.5%	\$57,155,220	27.0%
US Totals	128,599,631	21,721,218	70.6%	28.8%	4.5%	\$2,896,229,700	16.6%

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\*Of those who received a refund

\*\*Calculated based on a \$150 average tax preparation fee and a \$100 average RAL fee.

**ENDNOTES**

1. A pseudonym was used to protect her identity.
2. IRS SPEC Return Information Database, Tax Year 2004 (December 2006). All figures contained in this report have been retrieved from the 2004 SPEC database unless otherwise noted. CDF calculations.
3. Alan Berube, *Using the Earned Income Tax Credit to Stimulate Local Economies* (The Living Cities Policy Series, 2007).
4. Steve Holt, *The Earned Income Tax Credit at Age 30: What We Know* (Washington: Brookings Institution, 2006).
5. RALs purchases declined in the 2004 tax year, due to more education and awareness, advocacy, and changes to IRS reporting. Chi Chi Wu, *One Step Forward, One Step Back: Progress Seen in Efforts Against High-Priced Refund Anticipation Loans, but Even More Abusive Products Introduced* (Boston: National Consumer Law Center, 2007).
6. Chi Chi Wu, *One Step Forward, One Step Back*.
7. *2004 Update: Increased Participation in the Earned Income Tax Credit in San Antonio* (Austin: Texas Perspectives, 2004). CDF calculations.

Children's Defense Fund®

**Healthy Child Campaign**



In addition to the EITC and access to VITA sites, health insurance is critical to financial stability. Health care costs have increased drastically in recent years, leaving an estimated 9 million children uninsured. Families that lack medical insurance tend to have higher credit card debt because they cannot pay for services, and, as a result, medical expenses account for nearly 50 percent of bankruptcy filings. CDF unveiled a legislative proposal in January that would ensure that all children would receive coverage for all medically necessary care. For more information, visit [www.childrensdefense.org/healthychild](http://www.childrensdefense.org/healthychild).