



Children's Defense Fund

# The Children's Defense Fund - Mississippi

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

**M**ore 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.

In Mississippi, more than 366,000 taxpayers claimed \$769 million in the EITC, but they lost an estimated \$57 million 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 Mississippi taxpayers claiming the EITC who also received other tax credits was \$3,046.

### *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 nearly 73 percent of Mississippi's 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 four percent of their total refund.<sup>4</sup> Statewide tax preparation costs represent about \$32 million lost to poor working families.<sup>5</sup>





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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.

**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 163 percent<sup>6</sup>—just to get their refund one or two weeks sooner. This means needy Mississippi families lose an additional \$25 million in RAL fees.<sup>7</sup> When tax preparation fees are included, the typical family getting a RAL loses more than five percent of its federal refund. Between \$32 million in tax preparation fees and an additional \$25 million in RAL fees, Mississippi working families, and their communities, are deprived of \$57 million.

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 Mississippi

RAL vendors continue to target EITC families. According to IRS data, nearly 193,000—about 54 percent of EITC taxpayers in Mississippi receiving refunds for 2003 also took out RALs, whereas only 8.9 percent of the state's non-EITC taxpayers who received refunds 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. More than 54 percent of EITC families in Mississippi receive their refunds with a RAL—this is 20 percentage points higher than the national average of 34.2 percent. The child poverty rate in Mississippi's 25 counties with the highest percentage of RALs was 32.6 percent, significantly higher than the state rate and 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 across the nation 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.

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- 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. In Mississippi, CDF partners with many local organizations 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

Mississippi lost an estimated \$57 million 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*.



# 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>								
Tunica	2,778	55.6%	66.8%	20.0%	\$298,800	\$239,407	\$538,207	44.1%
Washington	10,693	48.1	65.6	14.9	867,600	900,904	1,768,504	38.5
Sharkey	1,226	54.5	65.6	11.6	59,520	103,271	162,791	50.4
Yazoo	4,332	44.5	65.0	13.7	376,440	360,572	737,012	43.1
Scott	4,624	40.4	63.0	13.6	451,560	368,876	820,436	27.5
Claiborne	1,754	51.2	62.8	16.5	157,920	141,516	299,436	40.8
Clay	2,934	37.7	62.7	15.4	273,360	235,547	508,907	34.4
Issaquena	194	56.9	62.6	18.2	9,840	15,789	25,629	43.2
Sunflower	5,528	55.2	62.3	13.3	437,640	443,844	881,484	39.8
Humphreys	2,283	58.7	61.6	12.4	137,640	180,695	318,335	50.5
Kemper	1,527	43.4	61.5	12.7	157,560	120,230	277,790	35.4
Simpson	3,564	34.7	61.1	14.1	347,160	273,324	620,484	26.0
Marion	3,725	37.6	60.8	15.5	327,600	285,136	612,736	32.6
Holmes	4,568	56.5	60.5	14.0	291,240	353,087	644,327	52.4
Madison	8,036	23.1	60.3	8.5	504,360	616,704	1,121,064	21.4
Pike	6,167	39.3	59.0	11.8	486,360	462,440	948,800	35.8
Walthall	1,882	42.1	58.8	11.6	165,120	140,112	305,232	42.8
Wilkinson	1,548	47.1	58.6	10.1	154,800	115,084	269,884	49.2
Monroe	4,820	31.3	58.0	14.7	481,680	354,374	836,054	22.5
Warren	6,855	32.4	57.8	12.2	535,200	507,117	1,042,317	28.0
Jefferson	1,596	53.9	57.5	16.8	140,640	118,242	258,882	46.0
Hinds	36,504	35.2	57.5	13.1	2,504,040	2,686,456	5,190,496	28.9
Benton	962	39.1	57.2	16.1	99,600	69,822	169,422	28.1
Marshall	5,845	37.6	57.2	17.9	588,120	423,494	1,011,614	28.7
Tallahatchie	2,688	55.2	56.9	12.1	257,640	195,900	453,540	43.8
<b>Ten Biggest Cities**</b>								
Jackson	30,017	40.3	59.7	14.8	2,049,000	2,300,271	4,349,271	34.0
Gulfport	10,574	29.9	53.8	13.7	933,240	723,601	1,656,841	26.2
Hattiesburg	8,403	29.4	54.8	10.2	768,000	585,945	1,353,945	36.6
Biloxi	6,448	23.4	45.6	11.4	528,120	370,981	899,101	20.1
Meridian	8,100	31.6	55.4	11.1	800,520	573,080	1,373,600	40.8
Brandon	3,551	13.9	42.3	7.8	291,360	187,245	478,605	7.7
Ocean Springs	3,835	17.6	39.0	9.3	303,720	187,362	491,082	4.6
Vicksburg	6,759	32.4	57.8	12.1	528,600	500,684	1,029,284	35.1
Columbus	6,388	31.6	54.9	9.8	489,000	447,938	936,938	41.0
Tupelo	4,726	25.9	52.9	9.0	462,480	316,831	779,311	17.7
<b>Mississippi Totals</b>	<b>366,555</b>	<b>32.2%</b>	<b>53.9%</b>	<b>8.9%</b>	<b>\$32 million</b>	<b>\$25 million</b>	<b>\$57 million</b>	<b>27.0%</b>
<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>\$908 million</b>	<b>\$2.7 billion</b>	<b>16.6%</b>

\* Of returns with a refund

\*\* Ten cities in the state with the highest total number of tax returns filed

SOURCE: IRS SPEC Return Information Data Base, Tax Year 2003 (October 2005). Poverty figures are from U.S. Census Bureau, 2000 Census. Calculations by CDF.

## 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 Block, 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/dybdacroot/es/urban/publications/berubekimeitc.pdf>.