

Children's Defense Fund — New York

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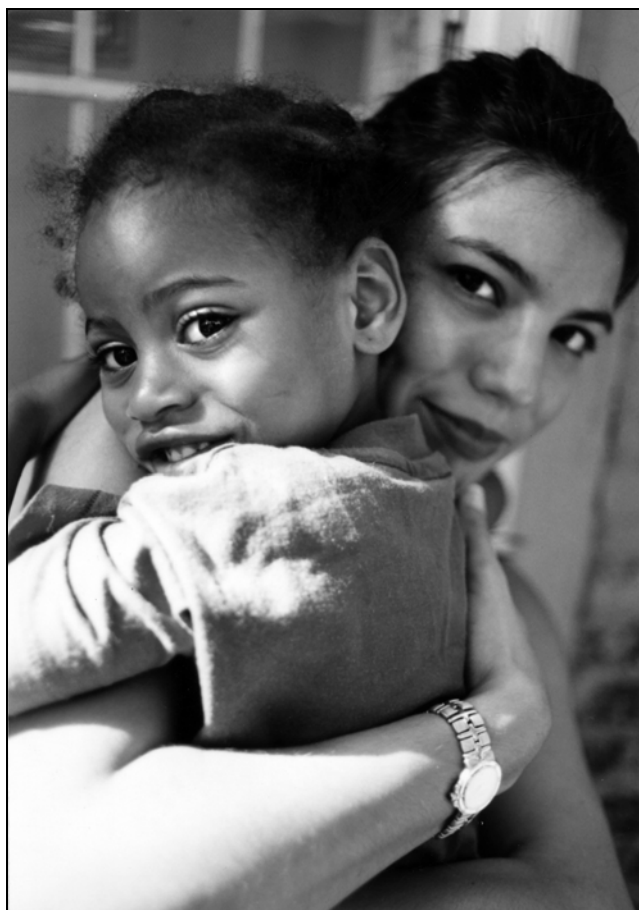
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Children's Defense Fund

KEEPING WHAT THEY EARNED



**THE HIGH COST OF
TAX PREPARATION
AND REFUND
ANTICIPATION
LOANS**

April 2007



A Brooklyn mother, earning approximately \$28,000 as a clerical worker in a billing department, visited a commercial tax preparer last year and paid more than \$200 to get her taxes prepared.

This year was different. A friend told her about a Volunteer Income Tax Assistance (VITA) site run by FoodChange in downtown Brooklyn. The VITA site prepared her taxes for free. This mom received a sizeable refund including an Earned Income Tax Credit (EITC) of approximately \$1,300, as well as the Child Tax Credit for her three-year-old son. She deposited her refund into her bank account to increase her savings and help secure her future. She stated that she will return to a VITA site next year to have her taxes prepared.

Nationally, millions of low- to moderate-income families will claim billions in Earned Income Tax Credit (EITC) refunds this tax season. 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 Refund Anticipation Loan (RAL) lenders:

- Nationwide, 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.¹ (This is based on a nationwide average tax preparation fee of \$150.)²
- In New York, more than 1.4 million taxpayers claimed an estimated \$2.6 billion through the federal EITC. These EITC claims were topped by only three other states and composed an estimated 6.5 percent of the national total. Still, New Yorkers lost \$205 million to tax preparation and Refund Anticipation Loan costs.

The Earned Income Tax Credit – A Support for Working Families

The EITC, which has lifted nearly 5 million Americans above the poverty line³, is a refundable tax credit for workers with low to moderate incomes. New York is one of only 20 states including the District of Columbia that offer a state EITC. New Yorkers who claim the EITC on their federal taxes can get an additional 30 percent of the value of their credit when they file their state taxes. New York City residents can also claim 5 percent of the federal credit when filing their city taxes.

To be eligible for the EITC in tax year 2006, a worker must have:

- Earned income from full-time, part-time or self-employment;
- Investment income of less than \$2,800;
- Earned less than \$36,348 (\$38,348 if married and filing jointly) if raising two or more children; or
- Earned less than \$32,001 (\$34,001 if married and filing jointly) if raising one child; or
- Earned less than \$12,120 (\$14,120 if married and filing jointly), not raising children and be between ages 25 and 64.

¹ 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. Calculations by CDF.

² 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).

³ Alan Berube, *Using the Earned Income Tax Credit to Stimulate Local Economies* (The Living Cities Policy Series, 2007).

For tax year 2006, this tax credit is worth up to:

- \$5,897 for workers raising two or more children (\$6,124 in New York City);
- \$3,571 for workers raising one child (\$3,708 in New York City); and
- \$536 for workers who are not raising children (\$556 in New York City).

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. It is worth up to \$1,000 for each child claimed in tax year 2006.

The EITC's 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.⁴ In 2004, the average total refund for New York taxpayers claiming the EITC who also received other federal tax credits was \$2,854. This money helps workers cover expenses like housing, utilities, food and child care – making it easier for working New Yorkers to keep working.

The High 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. Of the 1,449,615 EITC claimants in New York, almost 74 percent (1,069,387 households) paid to have their 2004 returns prepared professionally. These tax preparation fees drained more than \$176.4 million from the pockets of New York's working families, based on an average tax preparation fee in New York State of \$165.⁵

In addition to paying high fees to commercial tax preparers, many working families also use 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 federal tax refund and can end up costing the client a large percentage of their refund. The average New York EITC family purchasing a RAL paid \$100 to get their refund a mere five to seven business days sooner than if they had their refund directly deposited into a bank

account.



In New York, 288,672 filers claiming the 2004 EITC paid for a RAL. This translates to nearly a \$28.9 million loss for New York families in RAL fees.

RALs have a disproportionate effect on EITC-eligible families in New York. According to IRS data, almost 289,000 – more than 21 percent – of New York's EITC tax filers receiving refunds for 2004 also took out RALs, whereas less than 4 percent of non-EITC taxpayers in New York who received refunds purchased RALs for the same year.

⁴ Steve Holt, *The Earned Income Tax Credit at Age 30: What We Know* (Washington: Brookings Institution, 2006).

⁵ Rachel Cooper and Kimberley Chin, *Keeping What They Earned: Working New Yorkers & Tax Credits* (New York: Children's Defense Fund – New York, 2006)



The average EITC family in New York received a federal EITC refund of \$1,793. When tax preparation fees are included, the average EITC family purchasing a RAL lost 14.8 percent of their federal EITC refund to these fees. All total, New York's working families lost \$205.3 million to fees associated with paid tax preparation and Refund Anticipation Loans. That extra \$205.3 million could have gone a long way in helping lower-income families secure health insurance, pay down debt and bills or put food on the table. Table 1 on page seven summarizes the losses endured by New York's major cities and Table 2 provides detailed information for counties with the largest percentage of RAL uptake.

In 2004, new industry developments put lower-wage families at greater financial risk.⁶ 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 money is now accessible before the tax season begins. To complicate matters, some preparation businesses were requiring pay stub and holiday RAL purchasers to return to the same office once more to have their tax return completed.⁷

⁶ The number and cost of RALs purchased declined significantly in the 2004 tax year, possibly due to more education and awareness, advocacy and changes to IRS reporting. Chi Chi Wu, *One Step Forward, One Step Back*.

⁷ *Ibid*.

The Economic Impact of the EITC

While only a handful of studies have measured the economic impact of the Earned Income Tax Credit on local economies, their results are telling. Through the “multiplier effect,” the economic impact of each EITC dollar is amplified as it is spent in local economies and changes hands from the filer to a business, to another business, and so forth. 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.⁸ 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.



⁸ 2004 Update: Increased Participation in the Earned Income Tax Credit in San Antonio (Austin: Texas Perspectives, Inc., 2004). Calculations by CDF.

Recommendations

Hard-working New Yorkers lost an estimated \$205.3 million to tax preparation fees and RALs. Government officials and community leaders are in a unique position to set a precedent with policies that address the cause and mitigate the effect of RALs and costly tax preparation on lower-income communities. To that end, the Children's Defense Fund – New York recommends the following:

- 1) ***Strengthen consumer protections.*** New York 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. Since January 2007, bills have been introduced in the state legislature (A1794, S1545, S1677 and S3250) and sent to committee that have offered various methods of regulating RALs. These bills have included disclosure provisions, limits on fees or interest charged on RALs and a bill of rights for taxpayers.
- 2) ***Expand access to free and low-cost tax assistance.*** According to the IRS, only 2 percent of EITC recipients in New York State had their returns prepared at a free tax sites. Elected officials and community leaders must find ways to build and maintain free tax preparation networks throughout the state by investing in VITA and Tax Counseling for the Elderly programs and other free tax assistance centers. Government must provide resources to the sites, including funding, coordinated outreach to filers, electronic equipment and volunteer trainings. In communities where VITA sites are sparse or already serving filers to capacity, government agencies should publicize the numerous free and low-cost web-based tax preparation services that are available through websites such as www.irs.gov or www.thebeehive.org.

Further, government agencies, unions and community-based organizations should exercise their bargaining power to partner with paid preparers in a way that is advantageous to the consumer. The partnerships can offer discount tax preparation to qualifying consumers with the caveat that they do not purchase RALs, pay stub loans or other high-interest loan products. The Robin Hood Foundation, 1199SEIU United Healthcare Workers East and the New York City Department of Consumer Affairs have each partnered with large tax preparation companies to offer low-cost tax preparation (without high-interest loans) to consumers who still choose to use a private preparer. Projects like this should be closely monitored and evaluated.

- 3) ***Connect un-banked working families to mainstream financial services.*** National statistics show that one in four families with incomes of less than \$25,000 does not have a bank account.⁹ Basic banking accounts help consumers avoid check cashing and money order fees, and the ability to receive a federal tax refund in seven to 10 business days helps filers avoid costly RALs. Free or low-cost checking and savings accounts, credit counseling opportunities and financial education programs offer working families the tools to build a stronger financial future. Public/private partnerships should be explored and established to ensure that working families have easy access to these resources and a stronger understanding of how to manage them. For instance, agencies and organizations that assist families in need-based public programs should expand their services and utilize these partnerships. They should refer clients to voluntary financial education workshops and provide them with information on free banking and credit repair.

⁹Kenickell, A.B., Starr-McCluer, M., & Suerette, B.J. *Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances*. Federal Reserve Bulletin, January 2000.

Table 1: Percentage of RAL Purchases and EITC Dollars Lost in Major Cities, Tax Year 2004

City	Total Returns	Total EITC Returns	Percent of EITC Filers who used Paid Preparers	Percent of EITC Filers who purchased a RAL*	Percent of Non-EITC Filers who purchased a RAL*	Dollars lost to purchasing a RAL	Total dollars lost to tax prep and RAL**
ALBANY	68,869	10,946	71.4%	39.9%	4.6%	\$425,070	\$1,597,920
BUFFALO	101,911	30,796	75.2%	36.8%	5.7%	\$1,114,920	\$4,588,320
NEW YORK	3,344,740	814,991	76.0%	19.1%	4.8%	\$14,162,220	\$107,049,570
ROCHESTER	97,623	23,362	70.3%	36.6%	4.5%	\$835,560	\$3,299,460
SCHENECTADY	74,560	10,220	72.8%	34.3%	3.5%	\$339,930	\$1,455,780
SYRACUSE	72,031	15,084	73.1%	34.6%	3.6%	\$510,840	\$2,165,490
YONKERS	76,950	15,052	81.9%	27.5%	5.3%	\$391,500	\$2,241,600

Source: IRS SPEC Return Information Data Base Tax Year 2004 (December 2006). Poverty Figures from U.S. Census Bureau, 2000 Census. Calculations by CDF. *Of those who received a refund. **Calculated based on a \$165 average tax preparation fee and a \$100 average RAL fee.

Table 2:

Top 25 Counties with the Highest Percentage of RAL Purchases and EITC Dollars Lost Tax Year 2004

County	Total Returns	Total EITC Returns	Percent of EITC Filers who used Paid Preparers	Percent of EITC Returns with RAL*	Percent of Non-EITC Returns with RAL*	Total Dollars Lost to Tax Prep and RAL**	Child Poverty Rate
SULLIVAN	33,506	6,218	78.1%	35.8%	8.0%	\$1,012,230	22.8%
ALBANY	133,404	16,911	69.4	35.2	3.9	\$2,513,730	13.2
SCHENECTADY	79,316	10,645	72.7	33.9	3.5	\$1,625,115	16.1
FULTON	25,948	4,895	72.8	33.7	6.5	\$747,300	18.4
RENSSELAER	72,806	9,288	69.8	32.7	4.8	\$1,362,135	12.5
CHEMUNG	37,241	6,609	71.4	32.5	4.6	\$986,895	19.0
CORTLAND	19,980	3,432	71.8	31.7	5.3	\$510,945	17.1
ONEIDA	102,332	16,949	65.8	29.1	3.9	\$2,315,850	19.4
OSWEGO	53,417	9,526	69.5	29.0	4.3	\$1,358,715	17.8
MONROE	337,501	48,326	67.9	28.8	2.4	\$6,762,780	15.9
MONTGOMERY	24,371	4,291	75.0	28.7	4.5	\$650,205	17.4
ONONDAGA	208,538	29,959	70.0	27.9	2.6	\$4,269,105	15.8
BROOME	90,652	13,809	61.9	27.7	3.4	\$1,779,555	16.5
JEFFERSON	48,811	9,805	64.1	27.7	7.5	\$1,301,025	17.4
CAYUGA	32,454	5,153	71.0	27.2	3.9	\$738,990	15.4
WASHINGTON	27,444	4,602	68.6	27.1	5.1	\$638,430	12.8
SCHUYLER	8,357	1,495	66.6	26.6	5.1	\$202,605	17.5
SENECA	13,848	2,181	64.3	26.6	4.5	\$287,310	15.8
NIAGARA	99,039	14,489	72.2	26.4	3.1	\$2,099,070	15.3
WAYNE	43,920	6,508	70.1	26.4	3.5	\$917,475	11.3
ERIE	417,654	59,112	71.5	26.4	2.5	\$8,494,245	17.6
TIOGA	22,743	3,584	66.3	26.3	4.5	\$481,425	10.9
STEUBEN	41,576	7,412	68.6	25.8	4.4	\$1,022,385	19.3
MADISON	30,393	4,393	69.0	25.4	3.8	\$606,915	11.4
BRONX	509,429	192,634	78.6	25.2	9.2	\$29,601,900	41.7
NEW YORK TOTALS	8,384,979	1,449,615	73.8%	21.5%	3.7%	\$205,316,085	20.0%
US TOTALS	128,599,631	21,721,218	70.6%	28.8%	4.5%	\$2,896,229,700	16.6%

Source: IRS SPEC Return Information Data Base Tax Year 2004 (December 2006). Poverty Figures from U.S. Census Bureau, 2000 Census. Calculations by CDF. * Of those who received a refund. **Calculated based on a \$100 average RAL fee. New York calculations are based on a \$165 average statewide tax preparation fee, while nationwide calculations are based on a \$150 average nationwide tax preparation fee.

Children's Defense Fund – New York

The Children's Defense Fund's Leave No Child Behind® mission is 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.

CDF provides a strong, effective voice for *all* the children of America who cannot vote, lobby, or speak for themselves. We pay particular attention to the needs of poor and minority children and those with disabilities. CDF educates the nation about the needs of children and encourages preventative investments before they get sick, into trouble, drop out of school, or suffer family breakdown.

CDF began in 1973 and is a private, nonprofit organization supported by foundation and corporate grants and individual donations. We have never taken government funds.

In 1992, the Children's Defense Fund established an office in New York City. We are recognized as an authority in the endeavor to protect children and strengthen families. Our unique approach to improving conditions for children by combining research, public education, policy development, community organizing and advocacy activities has made CDF-NY an innovative and tireless leader for New York's children.



Acknowledgements

This report was prepared by Kimberley Chin and Diana Breen.
Many thanks to Anne Marie Costello for her editorial suggestions.

