



Children's Defense Fund

The Children's Defense Fund - South Carolina

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February 2006

Keeping What They've Earned: Tax Credits for Working Families in South Carolina

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.

In South Carolina, more than 415,000 taxpayers claimed \$781 million in the EITC, but they lost an estimated \$65 million to tax preparation and high-interest loans during the 2003 tax year.¹ 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.² 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 South Carolina taxpayers claiming the EITC who also received other tax credits was \$2,851.

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 year to year. In addition, many low-income families face language and literacy barriers. Consequently, it is not surprising that more than 78 percent of South Carolina 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.³ For EITC families living paycheck to paycheck, this is a significant amount of money—more than four percent of their total refund.⁴ In South Carolina, tax preparation costs represent about \$39 million lost to poor working families.⁵





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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 long-time married couple living in Marlboro County, South Carolina, visited a Volunteer Income Tax Assistance (VITA) site, a free tax preparation site sponsored by the Children's Defense Fund. They were struggling to get by but managed to make ends meet with a small Social Security benefit and sporadic part-time work at a national fast food chain and local farm. They learned that they could receive larger tax benefits if they filed jointly and were pleasantly surprised to discover they would soon receive a \$1,172 tax refund. If they had used a commercial tax preparer, they likely would have paid \$120 to have their taxes prepared and an additional \$130 for a Refund Anticipation Loan. This would have meant spending \$250—more than 20 percent of their refund—just to get their tax refund a week or two sooner. They were so pleased with the level of service at the VITA site that they recommended the site to their family members—several of whom also came to have their taxes prepared for free.

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. In South Carolina, the average EITC family purchasing a RAL paid \$130—equal to a loan with an Annual Percentage Rate (APR) of about 174 percent⁶—just to get their refund one or two weeks sooner. This means needy South Carolina families lose an additional \$26 million in RAL fees.⁷ When tax preparation fees are included, the typical family getting a RAL loses nearly six percent of its federal refund. Between \$39 million in tax preparation fees and an additional \$26 million in RAL fees, South Carolina working families, and their communities, are deprived of \$65 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.⁸ 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 South Carolina

RAL vendors continue to target EITC families. According to IRS data, more than 202,000—nearly half of South Carolina's EITC tax filers receiving refunds for 2003—also took out RALs, whereas only 7.7 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 child poverty than the national average. Fifty percent of EITC families in South Carolina receive their refunds with a RAL—much higher than the national average of 34.2 percent. The child poverty rate in South Carolina's 25 counties with the highest percentage of RALs purchased by EITC families was 25 percent, well above the state rate and more than 50 percent above the national rate of 16.6 percent.⁹ In fact, research indicates that commercial tax preparers target low-income neighborhoods for their services. Neighborhoods nationwide with high percentages of EITC filers have 50 percent more electronic tax filing and preparation services than those with low percentages of EITC filers.¹⁰

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.
- 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

South Carolina lost an estimated \$65 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
Highest RAL Counties								
Dillon	5,226	42.5%	63.7%	17.2%	\$481,800	\$425,365	\$907,165	33.4%
Allendale	1,865	50.4	63.1	18.3	188,520	150,755	339,275	48.1
Marlboro	4,931	42.8	62.7	18.8	477,480	397,296	874,776	29.4
Marion	5,685	42.0	61.1	14.3	525,360	444,663	970,023	33.6
Jasper	2,712	37.2	60.3	18.0	271,200	207,010	478,210	26.5
Bamberg	2,233	39.1	60.3	16.4	176,640	171,924	348,564	35.4
Edgefield	2,119	32.0	58.3	14.4	202,200	155,667	357,867	19.8
Chesterfield	5,502	33.2	58.1	17.3	590,160	408,056	998,216	25.0
Mccormick	1,260	29.3	58.0	13.7	125,400	93,564	218,964	26.6
Darlington	8,965	33.2	57.4	14.9	879,840	654,831	1,534,671	27.0
Lee	2,787	43.8	57.1	17.3	252,840	203,736	456,576	25.8
Laurens	6,382	29.2	57.1	12.2	657,600	462,674	1,120,274	20.1
Calhoun	1,418	31.6	57.0	11.5	125,880	102,570	228,450	20.5
Abbeville	2,568	30.5	57.0	13.7	258,720	186,543	445,263	17.8
Chester	4,355	30.6	56.5	14.4	411,360	313,907	725,267	21.5
Orangeburg	13,328	35.4	55.8	12.7	1,258,320	948,856	2,207,176	27.6
Saluda	1,607	30.3	54.1	12.9	146,880	109,119	255,999	21.9
Hampton	3,644	38.8	54.0	14.3	370,560	252,272	622,832	28.1
Barnwell	3,152	34.2	54.0	13.5	276,000	217,419	493,419	27.7
Florence	16,882	29.3	53.9	12.6	1,644,000	1,156,451	2,800,451	26.0
Greenwood	7,297	25.6	53.7	10.2	702,120	497,527	1,199,647	18.2
Clarendon	4,592	37.8	53.5	12.0	443,280	313,790	757,070	28.2
Williamsburg	5,855	44.7	53.5	14.1	548,520	401,156	949,676	36.2
Cherokee	5,491	28.2	53.2	12.2	521,520	373,086	894,606	17.0
Union	3,383	28.8	53.2	11.1	338,160	228,296	566,456	19.4
Ten Biggest Cities**								
Columbia	27,630	21.6	50.8	9.6	2,445,120	1,786,020	4,231,140	30.2
Greenville	16,908	21.6	52.0	9.9	1,643,520	1,111,891	2,755,411	23.1
Charleston	14,902	19.1	49.6	8.3	1,372,680	929,441	2,302,121	24.8
Spartanburg	11,165	22.8	52.3	9.8	1,097,400	739,623	1,837,023	34.7
Myrtle Beach	7,829	17.3	37.3	7.4	662,160	361,157	1,023,317	17.8
Rock Hill	8,536	21.4	51.9	10.4	803,040	562,904	1,365,944	16.7
Summerville	7,050	18.7	42.7	9.6	633,960	379,285	1,013,245	10.3
Anderson	8,117	22.5	51.9	9.6	775,440	533,198	1,308,638	30.6
Florence	8,888	25.2	54.2	11.5	860,280	613,663	1,473,943	28.5
Sumter	10,152	30.5	52.0	10.8	947,640	671,906	1,619,546	22.0
South Carolina								
Totals	415,474	23.5%	50.0%	7.7%	\$39 million	\$26 million	\$65 million	18.8%
U.S. Totals	21.4 million	16.9%	34.2%	5.1%	\$1.8 billion	\$908 million	\$2.7 billion	16.6%

* 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

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

² 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>.

³ 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>.

⁴ These values are based on all EITC claimants who receive a refund.

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

⁶ 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.

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

⁸ 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.

⁹ U.S. Census Bureau, 2000 Census. Calculations by CDF.

¹⁰ 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>.