



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

Vivian, a single mother of three earns \$35,000 as an office manager. Last year she went to a large tax preparer and paid \$182 to have her taxes completed and to receive a Refund Anticipation Loan (RAL). She also paid an additional \$99 in bank fees for the transfer—all to get her money in two days. If she had known that it takes Volunteer Income Tax Assistance (VITA) sites approximately 14 days to get her refund with direct deposit and electronic filing, she would not have visited a paid preparer. This year, Vivian has an appointment at the free VITA site near her home which will save her the \$281 that she paid last year. She plans to use the money from the Earned Income Tax Credit (EITC) and free tax filing to help her make a down payment on a house so that she can keep her children safe and secure.

Vivian's experiences getting her taxes done at a paid preparer are not unusual. Millions of low- to moderate-income families will claim billions of dollars in 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:

- More than 21.7 million taxpayers received the EITC in 2004, representing a \$39.8 billion investment in children, families, and communities in which they live, work, and play. Tax preparation fees and RALs drained nearly \$2.9 billion from this investment.¹
- In California, over 2.3 million taxpayers claimed an estimated \$4.3 billion in credits. These EITC claims were topped by only 1 other state and composed an estimated 10.7 percent of the national total. Still, Californians lost an roughly \$307 million to tax preparation fees and high interest loans.

Support for Working Families

Each year, the EITC lifts nearly 5 million Americans above the poverty line.² 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.³ 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 workers between 25 and 64 with no children.

In addition, many EITC recipients are eligible for other 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. In 2004, the average total refund for California taxpayers claiming the EITC who also received other tax credits was \$2,818.

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. Claiming these credits can be quite challenging, as large numbers of eligible families hire commercial preparers to complete their returns. In 2004, almost 76 percent paid to have their return completed professionally. Tax preparation fees drained nearly \$269 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. 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 their refund. In 2004, the average family in California purchasing a RAL paid \$100 just to get their refund one or two weeks sooner—meaning that hard-working families lost \$38 million to RAL fees. What's more troubling is that EITC recipients are five times as likely to purchase a RAL than taxpayers who did not file for the credit. According to IRS data, more than 382,000—over 17 percent— of California's EITC tax filers receiving refunds for 2004 also took out RALs, whereas less than 5 percent of non-EITC taxpayers who received refunds purchased RALs for the same year. Figure 1 illustrates the

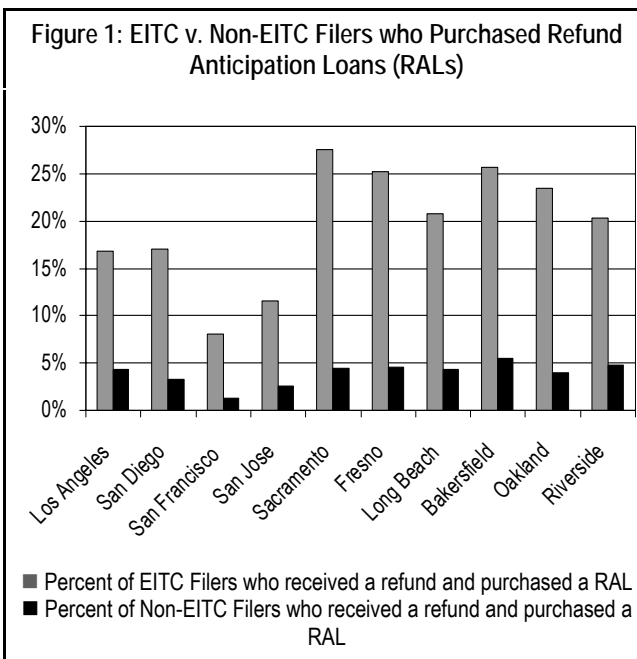


Figure 2: Total Dollars Lost to Tax Preparation and the Purchase of RALs in Cities with the Highest Total Number of Returns Filed, Tax Year 2004

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
Los Angeles	873,837	239,710	81.7%	16.8%	4.3%	\$33,082,200	30.7%
San Diego	532,294	71,342	71.7%	17.0%	3.3%	\$8,803,140	20.3%
San Francisco	389,164	39,574	65.3%	8.0%	1.3%	\$4,156,050	14.2%
San Jose	384,995	41,836	74.5%	11.5%	2.6%	\$5,116,470	10.9%
Sacramento	302,796	53,944	69.4%	27.6%	4.4%	\$7,039,410	29.9%
Fresno	190,934	51,197	68.9%	25.2%	4.5%	\$6,535,770	36.8%
Long Beach	188,681	39,678	78.9%	20.8%	4.3%	\$5,476,890	33.0%
Bakersfield	163,421	41,662	78.3%	25.7%	5.5%	\$5,924,160	14.2%
Oakland	157,281	25,696	69.7%	23.5%	4.0%	\$3,245,280	28.2%
Riverside	146,688	28,288	77.2%	20.3%	4.8%	\$3,823,410	19.3%
California Totals	14,593,144	2,378,899	75.4%	17.3%	3.2%	\$307,233,570	19.5%
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.

disproportionate usage of RALs by EITC families in the state's largest metropolitan areas. Between the costs of tax preparation and RAL fees, the typical California family loses an estimated 4.9 percent of its federal refund.

While RAL usage dropped in 2004, new industry developments put lower-wage families at greater financial risk.⁴ 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 require pay stub and holiday RAL purchasers to return to the same office to have their tax returns completed.⁵

Effects on Economic Activity

RAL fees and tax preparation costs represent a significant drain on local economies across California. Figure 2 summarizes the total dollars lost in California's largest urban areas while Figures 3 and 4 highlight the losses endured at the county level. As these Figures point out, 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 California's 10 counties with the highest percentage of RALs was 23.6 percent, higher than the state-wide rate of 19.5 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.⁶ 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. California families are similarly affected because fewer dollars in the hands of working families means less economic activity.

Recommendations

California families lost an estimated \$307 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 – California recommends the following:

1. ***Strengthen consumer protections.*** California is ahead of many states in the laws on the books that protect consumers. It has adopted legislation to regulate tax preparers by establishing ethical and professional conduct standards for tax preparers as well as penalties for breaking these laws. California also enacted a Refund Anticipation Loan law—fully supported by CDF—that requires full disclosure of RALS as loans and that obligates all RAL brokers to prominently display associated fees and to inform customers that they could receive their full refunds in about 10 days from the IRS without paying for a RAL if they have a bank about and direct deposit. Consumers and advocates must now ensure that the laws are being consistently administered in the state.

Figure 3: Total Dollars Lost to Tax Preparation and RALs in California 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
Los Angeles	3,876,220	804,408	80.7%	15.2%	3.3%	\$108,520,920	24.6%
San Diego	1,292,226	178,592	73.0%	17.9%	3.6%	\$22,540,650	16.9%
Orange	1,244,241	151,151	76.1%	13.0%	2.6%	\$19,027,260	13.6%
Santa Clara	724,685	63,332	71.4%	11.5%	2.1%	\$7,445,550	9.0%
Riverside	713,976	135,033	77.1%	19.2%	4.4%	\$18,067,710	19.0%
San Bernardino	713,447	154,863	78.1%	20.8%	4.8%	\$21,200,970	21.1%
Alameda	628,196	68,750	68.2%	19.3%	3.0%	\$8,255,460	13.8%
Sacramento	565,859	85,381	68.5%	25.1%	3.8%	\$10,807,710	20.6%
Contra Costa	434,317	37,800	68.3%	18.7%	2.3%	\$4,523,940	10.2%
San Francisco	388,839	39,587	65.4%	8.1%	1.3%	\$4,163,010	14.2%
Ventura	340,168	43,065	78.8%	14.2%	2.5%	\$5,660,850	12.1%
San Mateo	331,452	23,688	70.3%	11.0%	1.7%	\$2,728,830	6.5%
Fresno	313,275	84,485	69.2%	22.7%	4.3%	\$10,619,910	32.1%
Kern	256,895	68,944	78.0%	23.1%	5.0%	\$9,602,280	28.2%
San Joaquin	242,052	45,343	74.5%	26.1%	5.4%	\$6,201,240	24.2%
Sonoma	210,402	19,322	66.5%	12.9%	2.2%	\$2,152,710	9.0%
Stanislaus	188,656	36,088	74.0%	22.0%	5.3%	\$4,770,030	21.0%
Solano	170,187	20,356	66.1%	24.7%	4.2%	\$2,499,210	10.8%
Santa Barbara	168,466	22,308	74.4%	12.4%	1.9%	\$2,745,780	16.9%
Monterey	153,974	26,745	80.6%	15.5%	3.7%	\$3,628,410	17.9%
Placer	142,192	11,121	64.6%	15.2%	2.2%	\$1,233,420	6.7%
Tulare	136,397	43,188	73.9%	19.0%	3.8%	\$5,583,960	33.0%
Marin	122,863	7,025	65.6%	5.6%	0.6%	\$722,820	7.5%
Santa Cruz	116,961	15,568	71.9%	12.2%	1.8%	\$1,852,440	13.3%
San Luis Obispo	110,033	12,081	66.0%	12.2%	1.9%	\$1,327,920	12.0%
California Totals	14,593,144	2,378,899	75.4%	17.3%	3.2%	\$307,233,570	19.5%
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.

2. *Expand access to free tax assistance.* Large numbers of Californians 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.* California does not have a state Earned Income Tax Credit. Most poor children live in families with a working parent, and the creation of a state EITC could supplement wages and help lift a family out of poverty. For tax year 2006, only nineteen states, including the District of Columbia, had a state EITC in effect. Research indicates that tax refunds, including a state EITC refund, can be used to help families build assets while stimulating local economies.

Figure 4: California 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
Alpine	454	62	66.1%	30.0%	4.2%	\$7,770	30.2%
Kings	44,189	11,679	71.3%	27.0%	5.7%	\$1,557,420	26.4%
San Joaquin	242,052	45,343	74.5%	26.1%	5.4%	\$6,201,240	24.2%
Sacramento	565,859	85,381	68.5%	25.1%	3.8%	\$10,807,710	20.6%
Tehama	19,708	4,093	71.5%	24.9%	4.7%	\$535,680	24.5%
Solano	170,187	20,356	66.1%	24.7%	4.2%	\$2,499,210	10.8%
Tuolumne	22,918	3,024	70.9%	24.2%	4.6%	\$388,140	17.0%
Kern	256,895	68,944	78.0%	23.1%	5.0%	\$9,602,280	28.2%
Shasta	74,457	12,618	64.0%	22.9%	3.6%	\$1,484,880	21.9%
Fresno	313,275	84,485	69.2%	22.7%	4.3%	\$10,619,910	32.1%
Yuba	24,469	5,422	64.6%	22.2%	5.0%	\$641,400	27.9%
Stanislaus	188,656	36,088	74.0%	22.0%	5.3%	\$4,770,030	21.0%
Butte	84,053	13,999	65.2%	21.8%	4.1%	\$1,657,590	24.4%
Lassen	10,452	1,493	67.8%	21.4%	3.7%	\$182,730	16.7%
San Bernardino	713,447	154,863	78.1%	20.8%	4.8%	\$21,200,970	21.1%
Lake	23,704	4,496	65.1%	20.7%	3.7%	\$526,590	23.7%
Del Norte	8,971	1,724	57.4%	19.5%	2.7%	\$180,720	27.4%
Alameda	628,196	68,750	68.2%	19.3%	3.0%	\$8,255,460	13.8%
Riverside	713,976	135,033	77.1%	19.2%	4.4%	\$18,067,710	19.0%
Glenn	10,657	2,291	72.3%	19.1%	4.0%	\$289,980	26.5%
Plumas	8,835	1,207	65.9%	19.0%	2.7%	\$140,370	17.2%
Tulare	136,397	43,188	73.9%	19.0%	3.8%	\$5,583,960	33.0%
Contra Costa	434,317	37,800	68.3%	18.7%	2.3%	\$4,523,940	10.2%
Madera	44,886	10,880	76.0%	18.6%	4.0%	\$1,434,390	29.1%
Merced	81,249	21,251	68.5%	18.4%	4.9%	\$2,563,170	28.8%
California Totals	14,593,144	2,378,899	75.4%	17.3%	3.2%	\$307,233,570	19.5%
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.

ENDNOTES

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. CDF calculations.
2. Alan Berube, *Using the Earned Income Tax Credit to Stimulate Local Economies* (The Living Cities Policy Series, 2007).
3. Steve Holt, *The Earned Income Tax Credit at Age 30: What We Know* (Washington: Brookings Institution, 2006).
4. 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: Progress Seen in Efforts Against High-Priced Refund Anticipation Loans, but Even More Abusive Products Introduced* (Boston: National Consumer Law Center, 2007).
5. Chi Chi Wu, *One Step Forward, One Step Back*.
6. *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.