



Keeping What They've Earned: Tax Credits for Working Ohioans

While having her taxes prepared at a Volunteer Income Tax Assistance (VITA) site in Columbus, Sana Barrett was pleasantly surprised by the level of service, the professionalism of the volunteers, and the numerous educational opportunities offered to clients. The year prior, Sana learned of the Earned Income Tax Credit (EITC) and opted to have her tax return completed by a paid preparer—an experience which, she recalls, was void of personal attention and privacy. Though Sana was to receive a substantial boost to her yearly earnings by claiming the EITC, she paid \$395.00 to have her return prepared, to have it filed electronically, and to pay the up-front costs of a Refund Anticipation Loan (RAL). Reflecting on it now, Sana knows it was an unnecessary expense. But, as a single mother of four children facing difficult circumstances, she needed the extra money and thought there were no other options.

Sana's story, though troubling, is not atypical. 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 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.¹
- In Ohio, over 781,000 taxpayers claimed an estimated \$1.4 billion in credits. These EITC claims were topped only by 7 other states and composed almost 3.5 percent of the national total. Still, Ohioans lost an estimated \$100 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 also 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 Ohioans claiming the EITC and other tax credits was \$2,954.

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, almost 65 percent of EITC recipients in Ohio paid to have their return completed professionally. Tax preparation fees drained nearly \$76 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 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 a taxpayer a large percentage of his or her refund. In 2004, the average family in Ohio purchasing a RAL paid \$100 just to get their refund sooner—meaning that hardworking families lost \$24 million to RAL fees. What's more troubling is that EITC recipients are six times as likely to purchase a RAL than taxpayers who did not file for the credit. According to IRS data, more than 241,000—almost 32 percent—of Ohio'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 disproportionate usage of RALs by

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

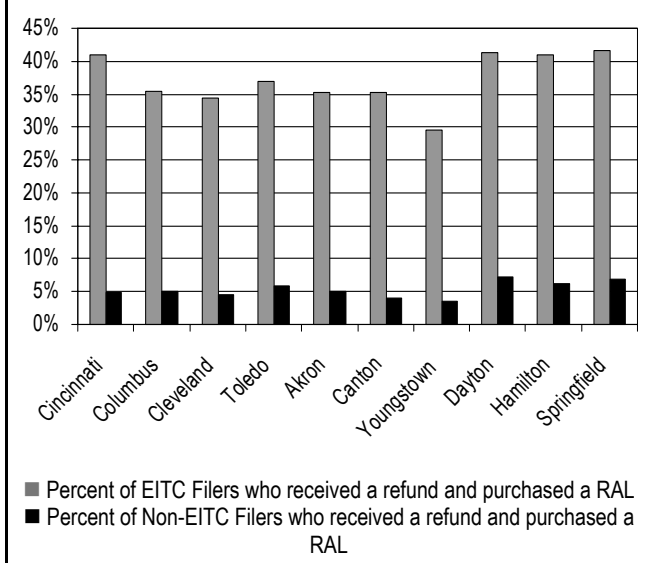


Figure 2: Total Dollars Lost to Tax Preparation and the Purchase of RALs in Cities with the Highest Total Number of Returns Filed, Tax Year 2004

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
Cincinnati	388,362	59,850	67.8%	40.9%	4.8%	\$8,472,240	32.5%
Columbus	356,866	67,696	66.2%	35.4%	5.1%	\$9,055,140	19.0%
Cleveland	320,597	72,942	67.7%	34.5%	4.6%	\$9,873,030	38.0%
Toledo	143,639	30,369	64.0%	37.0%	5.9%	\$4,020,000	26.1%
Akron	126,210	24,384	62.3%	35.2%	5.0%	\$3,147,600	26.0%
Canton	92,881	14,689	67.0%	35.3%	4.1%	\$1,979,130	28.1%
Youngstown	77,600	14,418	65.2%	29.6%	3.5%	\$1,826,040	37.7%
Dayton	74,175	19,297	65.8%	41.3%	7.2%	\$2,691,300	32.3%
Hamilton	57,457	8,177	69.7%	40.9%	6.2%	\$1,179,510	18.4%
Springfield	46,777	8,486	66.8%	41.6%	6.9%	\$1,195,620	24.6%
Ohio Totals	5,346,738	781,499	64.8%	31.9%	4.3%	\$100,110,660	14.4%
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.

EITC families in the state's largest metropolitan areas. Between the costs of tax preparation and RAL fees, the typical Ohio EITC family loses an estimated 4.5 percent of its federal refund.

Although RAL usage dropped significantly 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 refund. 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 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 Ohio. Figure 2 summarizes the total dollars lost in Ohio's largest urban areas while Figures 3 and 4 highlight the losses endured at the county level. Of note, three of the top five counties with the highest RAL purchase rates are some of the least populated and most impoverished in Ohio. These counties are clustered together in the southern region of the state and almost half of EITC recipients in these areas purchased a RAL in 2004.

Additionally, 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 child poverty rate in Ohio's 10 counties with the highest percentage of RALs was 17.9 percent, higher than the statewide rate of 14.4 percent 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 communities, 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. Ohio communities are similarly affected because fewer dollars in the hands of working families means less economic activity.

Recommendations

Ohio families lost nearly \$100 million because of tax preparation fees and RALs in 2004. Government officials and community leaders are in a 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—Ohio recommends the following:

1. ***Strengthen consumer protections.*** Ohio 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 2006, legislators established greater protections against unfair mortgage lending in the Consumer Sales Practices Act. This legislation was spurred by Ohio's nation-leading foreclosure rate and it could be used as a model to extend protections to working families at financial risk from commercial tax preparers and RAL lenders.

Figure 3: Total Dollars Lost to Tax Preparation and RALs in Ohio 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
Cuyahoga	629,993	107,711	65.9%	31.8%	3.6%	\$13,980,120	20.5%
Franklin	537,401	84,738	64.9%	33.3%	4.3%	\$10,986,420	24.4%
Hamilton	397,988	60,958	67.7%	40.8%	4.7%	\$8,611,440	16.6%
Montgomery	270,007	40,371	61.9%	34.3%	4.4%	\$5,098,980	28.3%
Summit	249,202	34,877	61.0%	30.8%	3.6%	\$4,229,070	15.5%
Lucas	199,391	34,554	63.3%	35.0%	4.8%	\$4,462,530	12.7%
Stark	191,202	27,381	65.9%	31.6%	3.8%	\$3,452,550	16.2%
Butler	155,732	19,271	69.4%	36.9%	5.2%	\$2,694,450	13.9%
Lorain	134,436	18,627	64.5%	30.1%	3.9%	\$2,348,580	9.4%
Lake	116,882	10,882	57.6%	19.4%	2.4%	\$1,142,430	21.0%
Mahoning	113,639	18,951	64.7%	28.0%	3.2%	\$2,352,210	15.3%
Trumbull	101,656	14,858	66.2%	29.6%	4.5%	\$1,898,760	10.1%
Clermont	92,475	10,399	64.5%	31.7%	4.8%	\$1,323,120	8.8%
Warren	82,068	6,547	65.2%	29.2%	3.6%	\$821,400	15.9%
Medina	80,526	6,255	56.9%	17.6%	2.1%	\$638,580	16.0%
Portage	75,510	8,504	62.7%	22.4%	3.2%	\$981,810	14.1%
Delaware	70,813	4,535	55.9%	22.5%	1.9%	\$475,980	25.8%
Licking	68,476	9,040	63.0%	28.0%	4.2%	\$1,097,070	27.6%
Clark	64,505	10,790	65.8%	39.1%	6.5%	\$1,476,420	20.0%
Greene	60,862	7,806	55.3%	27.9%	3.6%	\$858,750	25.6%
Richland	58,157	9,160	65.3%	35.5%	5.9%	\$1,212,510	15.8%
Fairfield	58,019	6,732	61.3%	27.2%	3.7%	\$793,920	14.5%
Wood	56,477	5,421	56.1%	23.2%	3.1%	\$577,260	18.5%
Wayne	54,447	6,541	68.4%	27.7%	4.2%	\$844,710	15.5%
Allen	52,410	8,400	64.7%	32.5%	4.8%	\$1,080,900	14.6%
Ohio Totals	5,346,738	781,499	64.8%	31.9%	4.3%	\$100,110,660	14.4%
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 Ohioans 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—particularly in rural communities—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.** State Representative Mike Foley recently introduced House Bill 17. It would create a refundable state EITC set at 5 percent of the federal credit in 2009 with an increase to 10 percent of the federal credit starting in 2010. A state EITC would represent an important investment in Ohio families and put the state on par with its Midwestern neighbors Michigan, Indiana, Illinois, Wisconsin, Minnesota, and Iowa.

Figure 4: Ohio 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
Jackson	13,328	2,936	65.4%	43.1%	10.6%	\$411,750	19.7%
Pike	10,455	2,411	60.2%	41.5%	8.3%	\$315,360	14.6%
Hamilton	397,988	60,958	67.7%	40.8%	4.7%	\$8,611,440	16.6%
Vinton	4,742	1,177	68.5%	40.7%	10.8%	\$167,430	15.8%
Clark	64,505	10,790	65.8%	39.1%	6.5%	\$1,476,420	20.0%
Fayette	12,377	2,234	67.2%	38.4%	8.1%	\$308,670	20.0%
Hocking	12,035	2,296	63.5%	37.7%	10.9%	\$300,900	13.3%
Marion	28,974	4,980	64.0%	37.6%	7.2%	\$661,200	9.4%
Butler	155,732	19,271	69.4%	36.9%	5.2%	\$2,694,450	13.9%
Adams	12,271	2,924	79.4%	36.6%	8.9%	\$449,880	6.8%
Ross	32,609	5,560	71.9%	36.3%	6.6%	\$794,550	19.4%
Clinton	21,861	3,318	64.2%	36.2%	6.7%	\$434,880	15.7%
Shelby	22,813	2,907	77.9%	35.7%	5.8%	\$441,060	9.1%
Richland	58,157	9,160	65.3%	35.5%	5.9%	\$1,212,510	15.8%
Highland	18,777	3,608	72.7%	35.4%	7.4%	\$515,370	6.3%
Pickaway	22,893	3,057	67.7%	35.4%	5.7%	\$414,000	10.2%
Scioto	30,393	7,112	70.1%	35.1%	6.9%	\$989,550	4.5%
Lawrence	25,590	5,976	69.2%	35.1%	7.5%	\$823,830	9.6%
Lucas	199,391	34,554	63.3%	35.0%	4.8%	\$4,462,530	15.5%
Gallia	12,847	2,716	76.0%	34.7%	7.4%	\$401,190	8.9%
Montgomery	270,007	40,371	61.9%	34.3%	4.4%	\$5,098,980	28.3%
Crawford	22,528	3,602	67.1%	34.3%	6.0%	\$482,610	7.6%
Muskingum	41,447	7,547	70.5%	34.2%	5.8%	\$1,048,260	7.8%
Brown	17,496	3,073	74.9%	34.1%	7.5%	\$444,510	10.9%
Franklin	537,401	84,738	64.9%	33.3%	4.3%	\$10,986,420	24.4%
Ohio Totals	5,346,738	781,499	64.8%	31.9%	4.3%	\$100,110,660	14.4%
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.