



## Keeping What They've Earned: Tax Credits for Working Texans

A 30 year old African American truck driver in Houston is raising two small children and trying to make ends meet on his limited income. In order for him to make repairs to his truck so that he can continue working, he is relying on a quick turn around on his tax refund of approximately \$2,200.00. He sees an ad for a commercial tax preparer, pays \$175.00 to have his taxes prepared, and receives the balance of his refund as a Refund Anticipation Loan (RAL). Unfortunately, he was not aware of free tax preparation sites, such as the Volunteer Income Tax Assistance (VITA) program, that offer electronic filing and direct deposit with a bank account so that taxpayers can get their refunds in about 10 days without paying exorbitant fees.

This tax season, millions of low- to moderate-income families will claim billions of dollars in EITC refunds. 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.<sup>1</sup>
- In Texas, over 2.2 million taxpayers claimed an estimated \$4.5 billion in Earned Income Tax Credits. Texas had the most EITC claims in the country—which composed an estimated 11.2 percent of the national total. Still, Texans lost an estimated \$305 million to tax preparation and high interest loans.

### Support for Working Families

Each year, the EITC lifts nearly 5 million Americans above the poverty line.<sup>2</sup> 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.<sup>3</sup> 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 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. In 2004, the average total refund for Texas taxpayers claiming the EITC who also received other tax credits was \$3,220.

### Costs of Using Commercial Tax Preparers and Refund Anticipation Loans

In order to claim the EITC and CTC, taxpayers must file their federal tax returns. This task can be quite challenging, as large numbers of EITC-eligible families hire commercial preparers to complete their returns. In 2004, over 72 percent paid to have their return completed professionally. Tax preparation fees drained over \$235 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 the client a large percentage of their refund. In 2004, the average family in Texas purchasing a RAL paid \$100 just to get their refund one or two weeks sooner—meaning that hard-working families lost \$70 million in RAL fees. What's more troubling is that EITC recipients are about 5 times as likely to purchase a RAL than taxpayers who did not file for the credit. According to IRS data, over 700,000—or 33 percent—of Texas' EITC tax filers receiving refunds for 2004 also took out RALs, whereas only 7 percent of non-EITC taxpayers who received refunds purchased RALs for the same year. Figure 1 illustrates the disproportionate usage of RALs by EITC families in the state's largest cities. Between the costs of tax preparation and RAL fees, the typical EITC family in Texas getting a RAL loses an estimated 4.5 percent of its federal refund.

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

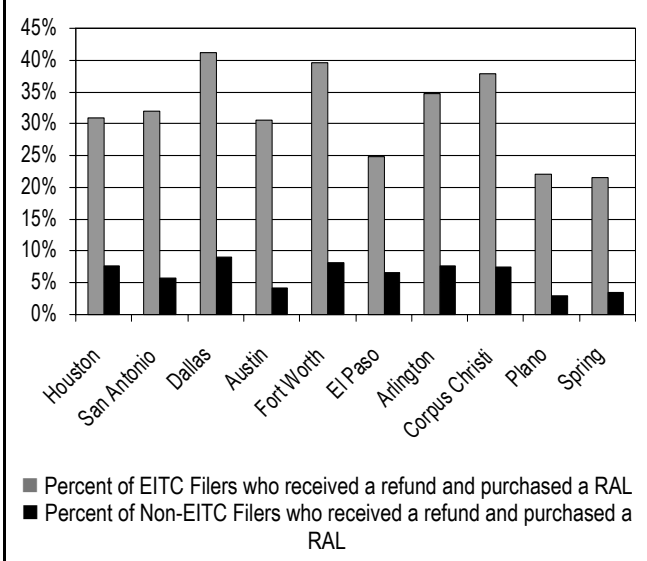


Figure 2: Total Dollars Lost to Tax Preparation and the Purchase of RALs in Cities with the Highest Total Number of Returns Filed, Tax Year 2004

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
Houston	1,075,839	282,217	75.4%	30.9%	7.6%	\$40,231,770	26.4%
San Antonio	598,819	158,611	67.0%	32.0%	5.7%	\$20,889,120	24.6%
Dallas	499,983	123,858	75.9%	41.2%	9.1%	\$19,021,470	25.5%
Austin	359,067	51,656	60.6%	30.5%	4.2%	\$6,191,370	17.0%
Fort Worth	297,112	71,537	74.9%	39.6%	8.1%	\$10,795,830	21.8%
El Paso	266,845	102,320	73.9%	24.9%	6.6%	\$13,831,440	30.1%
Arlington	150,288	29,195	69.4%	34.8%	7.6%	\$4,012,620	12.7%
Corpus Christi	119,779	33,020	65.2%	37.9%	7.4%	\$4,451,580	23.3%
Plano	111,032	9,712	61.0%	22.0%	3.0%	\$1,087,680	4.9%
Spring	109,355	10,476	58.5%	21.6%	3.4%	\$1,133,130	5.2%
<b>Rio Grande Cities</b>							
Harlingen	28,869	10,781	73.5%	31.8%	7.1%	\$1,523,820	35.0%
Brownsville	63,357	33,323	84.4%	22.9%	6.7%	\$4,962,930	45.3%
Pharr	19,850	11,397	83.6%	21.6%	7.8%	\$1,669,320	46.6%
McAllen	45,476	17,276	77.8%	19.9%	5.7%	\$2,348,010	30.6%
Texas Totals	9,145,683	2,170,290	72.2%	33.5%	7.0%	\$305,145,180	20.5%
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.

Although RAL usage dropped significantly in 2004, new industry developments put lower-wage families at greater financial risk.<sup>4</sup> 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.<sup>5</sup>

#### *Effects on Economic Activity*

RAL fees and tax preparation costs represent a significant drain on local economies across Texas. Figure 2 summarizes the total dollars lost in Texas' largest cities and select cities in the Rio Grande Valley. Figures 3 and 4 highlight the losses endured at the county level. Of note, 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 Texas' 10 counties with the highest percentage of RALs was 24.8 percent, higher than the state-wide rate of 20.5 as well as the national rate of 16.6 percent. And, although they are dispersed throughout the state, these counties are loosely clustered along the coast around the Panhandle, East Texas, and just northeast of the Rio Grande Valley.

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.<sup>6</sup> 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. Texas communities are similarly affected because fewer dollars in the hands of working families means less economic activity.

#### *Recommendations*

Texas families lost an estimated \$305 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 tax preparation on lower-income communities. To that end, Children's Defense Fund—Texas recommends the following:

1. **Strengthen consumer protections.** Texas 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

Figure 3: Total Dollars Lost to Tax Preparation and RALs in Texas 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
Harris	1,495,842	348,098	74.1%	30.6%	7.1%	\$48,825,840	19.9%
Dallas	950,505	214,924	73.4%	38.7%	8.7%	\$31,680,750	18.4%
Tarrant	658,773	125,819	72.0%	37.0%	7.0%	\$18,078,240	14.2%
Bexar	642,355	167,447	66.9%	31.9%	5.6%	\$21,994,650	22.7%
Travis	389,807	58,118	61.0%	30.8%	4.5%	\$7,018,050	14.3%
Collin	284,749	28,099	63.4%	28.5%	4.3%	\$3,424,290	5.5%
El Paso	282,995	111,984	74.4%	25.2%	6.7%	\$15,257,610	31.7%
Hidalgo	222,456	114,868	81.0%	22.7%	7.2%	\$16,503,660	45.7%
Denton	210,959	24,529	64.2%	27.9%	5.0%	\$3,009,930	6.5%
Fort Bend	173,087	29,320	69.9%	28.9%	5.3%	\$3,879,510	8.8%
Montgomery	146,729	22,652	64.8%	29.1%	5.2%	\$2,828,430	11.4%
Nueces	133,528	37,890	66.4%	38.0%	7.7%	\$5,181,810	24.5%
Cameron	128,869	61,396	80.2%	26.8%	7.1%	\$8,989,260	43.4%
Williamson	128,597	14,914	59.2%	29.1%	4.4%	\$1,741,470	5.7%
Galveston	123,732	23,277	67.6%	37.5%	6.4%	\$3,201,420	18.0%
Bell	115,665	32,265	68.2%	37.3%	11.7%	\$4,485,450	16.6%
Brazoria	111,491	19,306	69.7%	34.1%	6.6%	\$2,651,490	12.9%
Lubbock	104,532	25,556	71.4%	41.7%	6.6%	\$3,769,800	21.9%
Jefferson	96,787	25,721	75.9%	40.4%	7.8%	\$3,941,940	25.0%
McLennan	89,896	22,404	67.8%	36.0%	7.0%	\$3,065,340	21.1%
Smith	80,233	17,864	76.5%	40.7%	8.8%	\$2,751,780	18.8%
Webb	79,723	36,807	72.9%	28.8%	7.7%	\$5,060,340	39.7%
Johnson	59,936	11,120	68.8%	37.9%	8.9%	\$1,551,690	11.1%
Brazos	58,634	11,442	68.9%	39.2%	4.9%	\$1,620,030	22.1%
Gregg	58,003	13,442	74.3%	40.4%	10.3%	\$2,025,960	21.0%
Texas Totals	9,145,683	2,170,290	72.2%	33.5%	7.0%	\$305,145,180	20.5%
US Totals	128,599,631	21,721,218	70.6%	28.8%	4.5%	\$2,896,229,700	16.6%

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interest rates that banks can charge for RALs. So far this legislative session three bills—HB 1344, SB 879, and SB 1905—were introduced that offer various provisions to address the regulation and disclosure of RALs.

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 by investing in the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs.
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 to ensure that working families have access to these resources.

4. **Create a State EITC.** Texas does not have a state Earned Income Tax Credit. Research indicates that tax refunds, can be used to help families build assets while stimulating local economies. Although it would be difficult to administer a state EITC in Texas because there is no state income tax, it could be possible to administer the credit as a direct payment.

Figure 4: Texas 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
Kenedy	160	74	71.6%	57.2%	18.0%	\$12,180	15.6%
Dawson	5,024	1,735	84.6%	50.9%	11.8%	\$306,060	29.3%
Howard	11,712	3,167	73.3%	50.2%	10.8%	\$503,610	25.2%
Hale	14,105	5,107	76.9%	48.9%	10.6%	\$833,880	23.6%
Navarro	17,079	4,812	74.8%	48.7%	11.1%	\$768,180	23.7%
Delta	1,972	470	77.7%	48.6%	9.7%	\$76,530	21.7%
Floyd	2,831	973	80.7%	48.5%	8.8%	\$163,380	29.0%
Kleberg	12,043	3,675	63.2%	47.8%	9.6%	\$520,050	35.7%
Karnes	5,308	1,544	84.2%	47.7%	9.4%	\$265,920	29.5%
Washington	13,539	2,737	77.9%	47.5%	5.6%	\$445,290	15.1%
Shelby	9,456	2,842	77.9%	47.0%	13.1%	\$460,380	25.1%
Lamb	5,711	1,821	81.2%	46.9%	10.1%	\$304,740	27.9%
Brooks	3,043	1,411	81.0%	46.7%	14.8%	\$236,340	51.8%
Bee	9,305	3,138	81.5%	46.5%	13.3%	\$526,500	34.2%
Bowie	36,545	9,263	73.3%	46.5%	8.7%	\$1,437,540	25.5%
Camp	5,225	1,543	78.4%	46.2%	10.9%	\$251,250	30.2%
Jackson	5,620	1,340	77.2%	45.9%	10.9%	\$214,650	19.4%
Cherokee	15,934	4,902	83.1%	45.9%	11.4%	\$830,700	23.5%
Swisher	3,182	932	67.5%	45.7%	6.5%	\$135,660	24.5%
Refugio	3,289	817	72.1%	45.5%	9.7%	\$124,710	24.2%
McCulloch	3,438	977	85.1%	45.1%	12.0%	\$165,960	29.1%
Houston	8,534	2,499	76.6%	45.0%	9.0%	\$396,270	28.6%
Crosby	2,500	878	72.4%	44.6%	8.1%	\$133,470	36.9%
Hunt	29,532	7,079	72.8%	44.6%	10.4%	\$1,076,370	16.3%
Terry	4,565	1,538	86.1%	44.3%	9.9%	\$264,930	33.2%
Texas Totals	9,145,683	2,170,290	72.2%	33.5%	7.0%	\$305,145,180	20.5%
US Totals	128,599,631	21,721,218	70.6%	28.8%	4.5%	\$2,896,229,700	16.6%

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**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 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](http://www.childrensdefense.org/healthychild).