



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. Two years ago 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. Last year, Vivian had an appointment at the free VITA site near her home, which saved her the \$281 she had paid in preparation and RAL fees the prior year. She plans to return to a VITA site again this year. She is saving the money from the Earned Income Tax Credit (EITC) and free tax filing last year and this year 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 22 million taxpayers received the EITC in 2005, with an average benefit amount of \$1,894. This represents a \$41.8 billion investment in children, families and the communities in which they live, work and play.¹
- In California, about 2.4 million taxpayers received the EITC, representing a \$4.4 billion investment. Still, Californians lost roughly \$320 million to tax preparation fees, RALs and other commercial products.

Support for Working Families

Each year, the EITC lifts nearly 4.5 million Americans above the poverty line, including 2.4 million children.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 Without the crucial income supplement the EITC provides, it is estimated that the child poverty rate would be one-fourth higher.

For tax year 2007, the EITC federal tax credit is worth up to:

- \$4,716 for families with two or more children;
- \$2,853 for families with one child; and,
- \$428 for individuals between the ages of 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

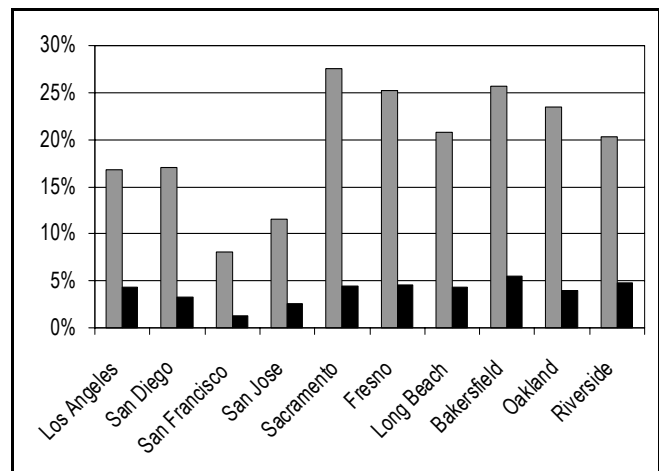
credit for working families with children and incomes above \$11,750. It is worth up to \$1,000 for each child claimed in tax year 2007. Overall, it has been estimated that the CTC adds as much as 40 percent to the refunds of EITC-eligible tax filers' refunds.

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 2005, almost 71 percent paid to have their return completed professionally. Tax preparation fees drained nearly \$2.3 billion in EITC benefits 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 often have triple digit interest rates. In 2005, a taxpayer purchasing a RAL typically paid \$100 just to get their refund sooner—meaning that hardworking families in California and individuals who received the EITC lost \$37 million in RAL fees. Figure 1 illustrates the disproportionate usage of RALs by EITC families in the state's largest metropolitan areas in tax year 2004.

Figure 1: EITC v. Non-EITC Filers who Purchased Refund Anticipation Loans (RALs), TY 2004



■ Percent of EITC filers who received a refund and purchased a RAL
■ Percent of non-EITC filers who received a refund and purchased a RAL

Between the costs of tax preparation and RAL fees, the typical California family loses an estimated 8.6 percent of its federal refund.

Start, and a *Moral Start* in life and successful passage to adulthood with caring families and communities.

Figure 2: Total Dollars Lost to Tax Preparation Fees, Refund Anticipation Loans (RALs) and Refund Anticipation Checks (RACs) in CA Cities with the Highest Number of Returns Filed, Tax Year 2005

City	Number of Tax Returns	Number of EITC Tax Returns	% of EITC Returns Who Used Paid Preparers	% of EITC Returns with a RAL*	Dollars Lost to Tax Preparation RACs and RALs**
LOS ANGELES	883,651	233,721	83.0%	15.5%	\$ 33,846,930
SAN DIEGO	537,792	70,113	72.3%	16.5%	\$ 8,937,960
SAN FRANCISCO	395,231	39,678	64.7%	8.0%	\$ 4,198,620
SAN JOSE	388,531	42,247	75.6%	11.6%	\$ 5,335,950
SACRAMENTO	303,733	54,371	70.6%	24.8%	\$ 7,305,510
FRESNO	193,551	52,153	71.0%	24.8%	\$ 7,123,590
LONG BEACH	190,206	39,673	80.2%	20.5%	\$ 5,742,900
BAKERSFIELD	169,552	42,876	79.3%	26.5%	\$ 6,489,630
OAKLAND	158,225	26,248	71.2%	23.4%	\$ 3,475,830
RIVERSIDE	149,430	28,160	78.5%	19.3%	\$ 3,988,050
CA TOTALS	14,801,518	2,376,158	76.3%	16.5%	\$ 319,651,470
U.S. TOTALS	130,354,745	22,053,667	70.9%	26.8%	\$ 3,029,007,780

SOURCE: Internal Revenue Service SPEC Information Database, Tax Year 2005 (December, 2007). CDF calculations.

* Of those who receive a refund

** Calculated based on a \$150 average tax preparation fee, a \$100 average RAL fee and a \$30 average RAC fee

EITC recipients are six times more likely to purchase a RAL than taxpayers who did not file for the credit. According to IRS data, more than 367,000—almost 17 percent—of California’s EITC tax filers receiving refunds for 2005 also took out RALs, whereas only 3.0 percent of non-EITC taxpayers who received refunds purchased RALs for the same year.

Recent data from the IRS shows that 17% of California EITC taxpayers who received a refund anticipation check drained \$11.2 million from their total refund.

While RAL usage has dropped among EITC recipients for the second year in a row, 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 Figure 3 shows counties with the highest number of returns filed. Lastly, Figure 4 highlights the losses endured by counties with the highest percentage of RAL purchases among EITC claimants. As these Figures illustrate, counties with high rates of RAL usage

also tend to have higher rates of child poverty than the national average.

While only a handful of studies have measured the economic impact of the EITC on local economies, their results are telling. An analysis of EITC population and participation rates by researchers in San Antonio, Texas 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 locally.

Recommendations

California families lost an estimated \$320.2 million because of tax preparation fees and RALs in 2005. 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

Figure 3: CA Counties with the Highest Number of Total Returns Filed, Tax Year 2005

County	Number of Tax Returns	Number of EITC Tax Returns	% of EITC Returns Who Used Paid Preparers	% of EITC Returns with a RAL*	Dollars Lost to Tax Preparation RACs and RALs**
LOS ANGELES	3,914,636	791,533	81.6%	14.1%	\$ 111,173,160
SAN DIEGO	1,305,036	176,582	73.8%	17.4%	\$ 23,120,160
ORANGE	1,269,017	148,774	76.6%	11.8%	\$ 19,202,040
RIVERSIDE	751,826	140,945	78.7%	18.8%	\$ 19,950,450
SANTA CLARA	747,823	65,597	72.6%	11.6%	\$ 7,995,180
SAN BERNARDINO	731,802	157,656	79.1%	21.1%	\$ 22,797,900
ALAMEDA	634,434	69,996	69.3%	18.7%	\$ 8,738,040
SACRAMENTO	560,536	85,100	69.6%	22.6%	\$ 11,107,950
CONTRA COSTA	436,618	38,529	69.7%	17.4%	\$ 4,794,780
SAN FRANCISCO	394,918	39,680	64.8%	8.2%	\$ 4,206,570
VENTURA	346,285	42,375	79.1%	14.8%	\$ 5,787,120
FRESNO	319,333	85,724	71.3%	22.5%	\$ 11,528,430
SAN MATEO	318,569	21,565	68.8%	9.4%	\$ 2,456,010
KERN	265,294	70,623	78.8%	23.6%	\$ 10,429,140
SAN JOAQUIN	256,490	47,341	75.2%	24.5%	\$ 6,677,280
SONOMA	209,648	18,946	66.6%	12.3%	\$ 2,172,120
STANISLAUS	191,522	36,335	75.3%	22.2%	\$ 5,024,520
SOLANO	169,825	20,443	67.0%	21.3%	\$ 2,575,530
SANTA BARBARA	169,131	21,830	74.6%	12.7%	\$ 2,782,050
MONTEREY	153,957	26,261	82.8%	15.5%	\$ 3,796,320
PLACER	146,277	11,332	64.5%	13.8%	\$ 1,290,660
TULARE	139,844	43,598	75.5%	19.0%	\$ 5,992,020
MARIN	122,036	6,781	64.9%	5.7%	\$ 703,140
SANTA CRUZ	116,218	15,290	71.6%	8.3%	\$ 1,835,130
SAN LUIS OBISPO	111,912	11,891	66.9%	12.6%	\$ 1,373,610
CALIFORNIA TOTALS	14,801,518	2,376,158	76.3%	16.5%	\$ 319,651,470
U.S. TOTALS	130,354,745	22,053,667	70.9%	26.8%	\$ 3,029,007,780

SOURCE: Internal Revenue Service SPEC Information Database, Tax Year 2005 (December, 2007). CDF calculations.

* Of those who receive a refund

** Calculated based on a \$150 average tax preparation fee, a \$100 average RAL fee and a \$30 average RAC fee

and professional conduct standards for tax preparers as well as penalties for breaking these laws. California also enacted a Refund Anticipation Loan law (AB 843)—fully supported by CDF—that requires full disclosure of RALs as loans and that obligates all RAL brokers to prominently display associated fees and inform customers they could receive their full refunds in about 10 days from the IRS without paying for a RAL if they have a bank account and direct deposit. Consumers and advocates must now ensure that the laws are being consistently administered in the state.

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 2007, only 22 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: CA Counties with the Highest Percentage of Refund Anticipation Loan (RALs) Purchases, Tax Year 2005

County	Number of Tax Returns	Number of EITC Tax Returns	% of EITC Returns Who Used Paid Preparers	% of EITC Returns with a RAL*	Dollars Lost to Tax Preparation RACs and RALs**
ALPINE	475	69	60.9%	28.2%	\$ 8,190
SAN JOAQUIN	256,490	47,341	75.2%	24.5%	\$ 6,677,280
TUOLUMNE	23,006	3,023	71.0%	24.3%	\$ 398,550
KINGS	44,963	11,909	72.0%	23.9%	\$ 1,638,720
KERN	265,294	70,623	78.8%	23.6%	\$ 10,429,140
YUBA	25,363	5,503	66.2%	23.4%	\$ 690,420
TEHAMA	19,913	4,072	72.7%	23.3%	\$ 549,960
SACRAMENTO	560,536	85,100	69.6%	22.6%	\$ 11,107,950
FRESNO	319,333	85,724	71.3%	22.5%	\$ 11,528,430
STANISLAUS	191,522	36,335	75.3%	22.2%	\$ 5,024,520
LAKE	23,627	4,483	66.8%	21.9%	\$ 563,640
SHASTA	74,167	12,402	64.3%	21.4%	\$ 1,511,130
SOLANO	169,825	20,443	67.0%	21.3%	\$ 2,575,530
SAN BERNARDINO	731,802	157,656	79.1%	21.1%	\$ 22,797,900
LASSEN	9,468	1,372	66.1%	21.0%	\$ 171,540
DEL NORTE	9,076	1,760	57.1%	20.8%	\$ 193,530
BUTTE	84,467	14,018	66.1%	20.8%	\$ 1,723,380
MERCED	82,786	21,600	71.5%	20.1%	\$ 2,838,690
MARIPOSA	7,181	965	58.9%	19.8%	\$ 106,470
PLUMAS	10,225	1,336	67.3%	19.8%	\$ 163,410
MADERA	46,174	11,019	77.3%	19.0%	\$ 1,537,470
TULARE	139,844	43,598	75.5%	19.0%	\$ 5,992,020
RIVERSIDE	751,826	140,945	78.7%	18.8%	\$ 19,950,450
ALAMEDA	634,434	69,996	69.3%	18.7%	\$ 8,738,040
SUTTER	34,964	6,538	72.8%	17.7%	\$ 845,820
CALIFORNIA TOTALS	14,801,518	2,376,158	76.3%	16.5%	\$ 319,651,470
U.S. TOTALS	130,354,745	22,053,667	70.9%	26.8%	\$ 3,029,007,780


SOURCE: Internal Revenue Service SPEC Information Database, Tax Year 2005 (December, 2007). CDF calculations.

* Of those who receive a refund

** Calculated based on a \$150 average tax preparation fee, a \$100 average RAL fee and a \$30 average RAC fee

ENDNOTES

1. IRS SPEC Return Information Database, Tax Year 2005 (December 2007). All figures contained in this report have been retrieved from the 2005 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 2005 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. 2005 Update: *Increased Participation in the Earned Income Tax Credit in San Antonio* (Austin: Texas Perspectives, 2005). 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 over 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 2007 that would ensure that all children receive coverage for all medically necessary care. For more information, visit www.childrensdefense.org/healthychild.

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 caring families and communities.