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Moving Families Forward

# PAYCHECK$ and POLITICS

*Arkansas Advocates for Children and Families*
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## RABID REFUNDS:
## Refund Anticipation Loans and High Tax Preparation Fees Are Picking the Pockets of Arkansas's Working Families

*By Ginny Blankenship, Ed.D.*


### EXECUTIVE SUMMARY

• The federal earned income tax credit (EITC) was enacted in 1975 to provide tax relief to low- and moderate-income workers so that they could better provide for their families. It has since been expanded with strong bipartisan support in the Reagan, Bush, Clinton, and Obama administrations. Research has proven the EITC to be the most effective anti-poverty measure in our nation. Without it, there would be nearly 25 percent more children in poverty in America.

• One quarter of all Arkansas tax filers benefit from the EITC, bringing over a half a billion dollars into local economies. Arkansas must ensure that all eligible working families are claiming the tax credit that they are due and prevent our communities from leaving roughly $100 million in federal dollars on the table each year.

• **Arkansas Advocates for Children and Families (AACF) estimates that Arkansas's working families and communities are losing an additional $100 million every year due to the high cost of tax preparation services and the ultimate tax season rip-off: refund anticipation loans (RALs).** State and federal legislators must take further action to end predatory practices by tax preparation companies and banks. Local banks, businesses, and nonprofits should also partner with the state to create and market more affordable loan products and tax preparation services for Arkansas's working families.

• AACF's analysis found that RALS disproportionately impact Arkansas counties with the highest levels of poverty and African-American residents.

• The public and private sectors must work together to prevent this massive loss of revenue and help working families achieve economic self-sufficiency, including: holding tax preparation companies accountable; banning exorbitant RAL fees; partnering to advertise the EITC and free VITA tax prep; expanding VITA sites and alternatives to RALs; permanently extending the EITC increase in the federal stimulus package; and enacting a state EITC.

# INTRODUCTION

In public debates on taxes, it is often forgotten (or ignored) that the poor pay taxes just like everyone else. Not only do low-income working families pay a vast array of taxes—from payroll to sales taxes and from property taxes to driver's license fees—but as a percentage of their income, they also pay far more than everyone else.[1]

The federal earned income tax credit (EITC) was designed to help counter this injustice by supplementing the wages of the working poor and lessening their tax burden so that they could better provide for their families. Research has since proven the EITC to be the most effective anti-poverty measure in our nation.[2] In the 2009 tax season alone, the EITC lifted more than five million individuals (including 2.6 million children) out of poverty and helped millions of additional low- and middle-class families weather the current economic storm.[3] Through the federal economic stimulus package, the American Reinvestment and Recovery Act (ARRA) of 2009, even more working families will now benefit from an increased EITC, which could save millions more children from poverty nationwide.

However, the Internal Revenue Service estimates that 20 to 25 percent of all low-income tax filers are not claiming the credit that they are due, leaving millions of dollars on the table that could be going back into their pockets and stimulating local economies.[4] What's worse, too many working families are not reaping the full benefit of this tax credit due to the high cost of tax preparation services and falling prey to the ultimate tax season rip-off: refund anticipation loans (RALs). Given our state's high poverty rate, Arkansas's taxpayers and local economies cannot afford to lose any hard-earned dollars. Arkansas can stop the drain on our EITC dollars through simple policy changes and greater outreach—but only if advocates for children and families push for reform harder than the predatory lending industry pushes against it.

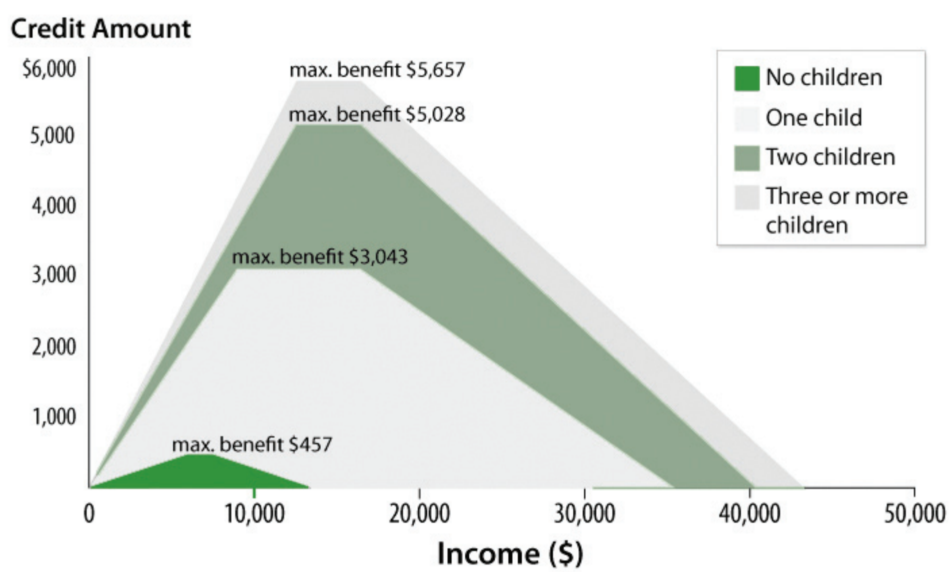
# WHAT IS THE EITC?

The federal earned income tax credit (EITC) was passed with strong bipartisan support in 1975 and expanded by Presidents Reagan, Bush, Clinton, and now Obama. This refundable tax credit helps families who work full-time at poverty-level wages buy the bare necessities and start building some assets for the future.

Not only does the EITC often wipe out any tax liability for the most impoverished families, but it also sends money back to families directly in the form of a cash refund that can be spent on basic needs, such as rising fuel prices or groceries.

Working families with incomes below about $35,000 to $43,000 (depending upon marital status, the number of children, and the number of hours worked in the previous year) are eligible for the EITC, with the largest benefits going to those below the federal poverty line ($22,050 for a family of four in 2009).[5] Benefits are gradually phased out as income rises and families move out of poverty and into the middle class. As the chart below illustrates, the maximum federal EITC benefit for the 2009 tax year was $3,043 for families with one child, $5,028 for families with two children, and $5,657 for those with three or more children. According to the latest available IRS data, the average refund for Arkansas tax filers was $2,079 in tax year 2006 (see Table 1).

## EITC in 2009 for unmarried filers




**Note: The maximum benefit level extends to higher incomes for married filers.**

Center on Budget and Policy Priorities

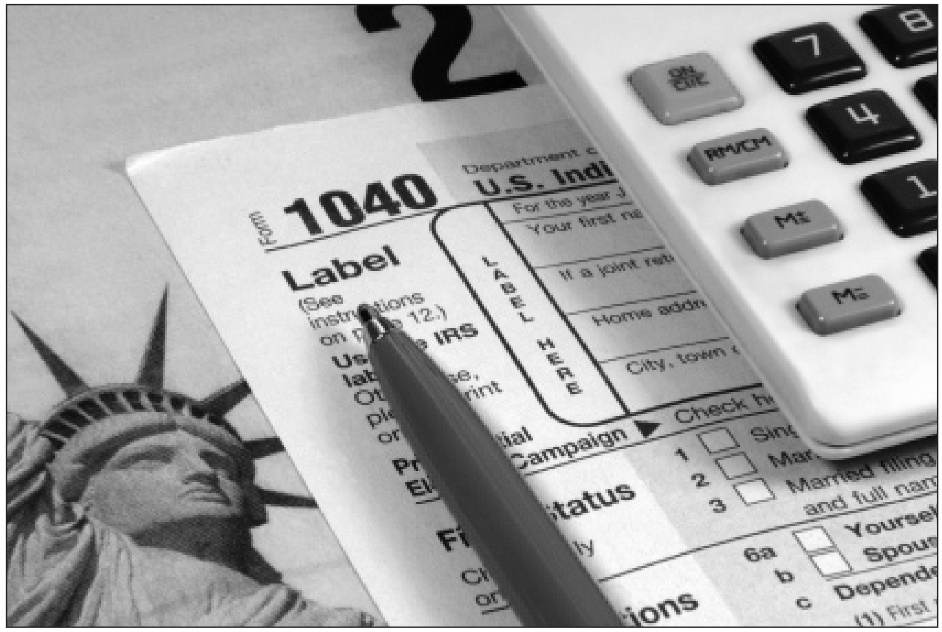
The federal EITC has been so successful in reducing poverty that 24 of the 42 states with personal income taxes (including the District of Columbia) have adopted state-level EITCs to build on the federal EITC.[6] While momentum builds across other states to enact a state EITC, Arkansas still lags behind in this critical tax reform.[7]

In response to the nation's recent economic crisis, President Obama expanded the federal EITC in the federal economic stimulus package, known as the American Recovery and Reinvestment Act (ARRA) of 2009. ARRA temporarily raises the maximum EITC for families with three or more children from $5,028 to $5,657. The stimulus also increases the phase-out income levels for all married couples filing a joint tax return (regardless of the number of children) to $5,000 above the thresholds for single filers, further reducing the "marriage penalty" of the EITC.[8]

## THE EITC BENEFITS ALL ARKANSANS

Although the purpose of the federal EITC was to help families escape poverty, research shows that the EITC creates a ripple effect in the economy, touching people of all income levels.[9] Working families use the EITC refund to pay off debt, finance transportation to work, invest in education, and buy basic necessities—nearly all of which stays in local communities.[10] It serves as a permanent "economic stimulus package" that targets those who need help the most, yet allows everyone to reap the benefits.

AACF obtained the latest EITC data from the IRS to view the impact that these dollars are having on Arkansas families and communities.




**THE EITC HAS A "MULTIPLIER EFFECT" ON LOCAL ECONOMIES**

- About two-thirds of EITC recipients spend their refunds on immediate expenses in local communities.
  Source: Spader, Ratcliffe, and Stegman (2005)
- The city of San Antonio estimated that each additional $1.00 in EITC claimed would generate $1.58 in local economic activity.
  Source: Texas Perspectives (2004)
- EITC dollars spent in Baltimore generate nearly $600,000 in annual local income and property tax revenues.
  Source: Jacob France Institute (2005)

**In the 2006 tax year, 24.5 percent of all Arkansas families filing federal tax returns claimed the federal EITC (compared to the U.S. average of 17 percent)—returning an average of $2,079 to their pockets and over half a billion dollars ($588 million) to the state's economy** (see Table 1).[11] If Arkansas had a 10 percent state EITC, it would have brought an additional $58.8 million to Arkansas communities.

Families in all 75 counties in Arkansas claim the credit. **Phillips County** had the highest participation and the highest average credit: almost half (46.5 percent) of all tax filers claimed the EITC, with an average credit of $2,518. **Benton County** had the lowest participation (16.9 percent), while **Van Buren County** had the lowest average credit ($1,715).

Table 1 (Pages 4-5) shows the number of federal tax return filers in Arkansas that claimed the federal EITC in tax year 2006 (the most recent year available), as well as the average tax credit they received and the total amount of federal EITC funding received in each county.[12]

## Table 1: Federal EITC Claims in Arkansas Counties in 2006

| County | Total # Tax Returns Filed | # Returns Claiming EITC | % Returns Claiming EITC | Total EITC $ Received* | Average EITC $ Per Tax Filer* |
|---|---|---|---|---|---|
| Arkansas | 8,120 | 2,177 | 26.8% | $4,589,019 | $2,108 |
| Ashley | 8,839 | 2,559 | 29.0% | $5,593,339 | $2,186 |
| Baxter | 18,265 | 3,303 | 18.1% | $6,171,265 | $1,868 |
| Benton | 81,348 | 13,742 | 16.9% | $28,153,194 | $2,049 |
| Boone | 15,793 | 3,443 | 21.8% | $6,301,667 | $1,830 |
| Bradley | 4,484 | 1,450 | 32.3% | $3,056,374 | $2,108 |
| Calhoun | 1,694 | 483 | 28.5% | $1,022,570 | $2,117 |
| Carroll | 10,844 | 2,685 | 24.8% | $5,330,173 | $1,985 |
| Chicot | 4,792 | 1,994 | 41.6% | $4,740,147 | $2,377 |
| Clark | 9,158 | 2,429 | 26.5% | $5,106,984 | $2,103 |
| Clay | 6,682 | 1,667 | 24.9% | $3,181,285 | $1,908 |
| Cleburne | 10,361 | 2,115 | 20.4% | $4,179,567 | $1,976 |
| Cleveland | 3,160 | 770 | 24.4% | $1,719,143 | $2,233 |
| Columbia | 9,798 | 2,794 | 28.5% | $5,972,112 | $2,137 |
| Conway | 8,105 | 1,943 | 24.0% | $4,053,115 | $2,086 |
| Craighead | 36,489 | 8,662 | 23.7% | $17,392,055 | $2,008 |
| Crawford | 24,002 | 5,736 | 23.9% | $11,718,380 | $2,043 |
| Crittenden | 20,488 | 7,758 | 37.9% | $18,802,564 | $2,424 |
| Cross | 7,246 | 2,274 | 31.4% | $5,208,621 | $2,291 |
| Dallas | 3,221 | 1,076 | 33.4% | $2,342,864 | $2,177 |
| Desha | 5,693 | 2,220 | 39.0% | $4,675,687 | $2,106 |
| Drew | 6,643 | 1,945 | 29.3% | $4,617,203 | $2,374 |
| Faulkner | 40,761 | 7,661 | 18.8% | $15,853,224 | $2,069 |
| Franklin | 6,985 | 1,549 | 22.2% | $3,150,974 | $2,034 |
| Fulton | 3,969 | 1,012 | 25.5% | $2,210,107 | $2,184 |
| Garland | 44,274 | 9,100 | 20.6% | $17,333,088 | $1,905 |
| Grant | 6,710 | 1,303 | 19.4% | $2,541,265 | $1,950 |
| Greene | 16,027 | 3,752 | 23.4% | $7,372,670 | $1,965 |
| Hempstead | 8,103 | 2,940 | 36.3% | $6,992,823 | $2,379 |
| Hot Spring | 12,163 | 2,967 | 24.4% | $5,891,575 | $1,986 |
| Howard | 6,222 | 1,902 | 30.6% | $3,740,041 | $1,966 |
| Independence | 13,941 | 3,289 | 23.6% | $6,758,048 | $2,055 |
| Izard | 5,059 | 1,241 | 24.5% | $2,237,030 | $1,803 |
| Jackson | 5,812 | 1,767 | 30.4% | $3,989,388 | $2,258 |
| Jefferson | 32,030 | 10,796 | 33.7% | $23,889,154 | $2,213 |
| Johnson | 9,216 | 2,551 | 27.7% | $5,357,720 | $2,100 |
| Lafayette | 2,752 | 969 | 35.2% | $2,092,995 | $2,160 |
| Lawrence | 7,309 | 2,014 | 27.6% | $3,860,929 | $1,917 |
| Lee | 3,217 | 1,336 | 41.5% | $3,248,670 | $2,432 |

| County | Total # Tax Returns Filed | # Returns Claiming EITC | % Returns Claiming EITC | Total EITC $ Received* | Average EITC $ Per Tax Filer* |
|---|---|---|---|---|---|
| Lincoln | 3,944 | 1,283 | 32.5% | $2,693,260 | $2,099 |
| Little River | 5,228 | 1,371 | 26.2% | $2,882,844 | $2,103 |
| Logan | 9,234 | 2,205 | 23.9% | $4,378,078 | $1,986 |
| Lonoke | 26,960 | 5,358 | 19.9% | $10,844,743 | $2,024 |
| Madison | 5,853 | 1,326 | 22.7% | $2,534,283 | $1,911 |
| Marion | 6,125 | 1,375 | 22.4% | $2,801,841 | $2,038 |
| Miller | 16,825 | 4,829 | 28.7% | $10,412,527 | $2,156 |
| Mississippi | 18,215 | 6,735 | 37.0% | $15,570,754 | $2,312 |
| Monroe | 3,482 | 1,282 | 36.8% | $2,922,926 | $2,280 |
| Montgomery | 2,936 | 704 | 24.0% | $1,556,225 | $2,211 |
| Nevada | 3,750 | 1,191 | 31.8% | $2,489,000 | $2,090 |
| Newton | 3,159 | 904 | 28.6% | $1,608,964 | $1,780 |
| Ouachita | 10,846 | 3,293 | 30.4% | $6,982,087 | $2,120 |
| Perry | 4,344 | 1,008 | 23.2% | $1,980,937 | $1,965 |
| Phillips | 8,397 | 3,903 | 46.5% | $9,827,015 | $2,518 |
| Pike | 4,118 | 1,069 | 26.0% | $1,925,239 | $1,801 |
| Poinsett | 9,685 | 3,066 | 31.7% | $6,305,837 | $2,057 |
| Polk | 7,718 | 2,126 | 27.5% | $4,403,856 | $2,071 |
| Pope | 24,172 | 5,484 | 22.7% | $10,754,663 | $1,961 |
| Prairie | 3,229 | 853 | 26.4% | $1,705,619 | $2,000 |
| Pulaski | 168,175 | 38,472 | 22.9% | $80,856,872 | $2,102 |
| Randolph | 6,515 | 1,695 | 26.0% | $3,548,259 | $2,093 |
| Saint Francis | 10,064 | 4,210 | 41.8% | $9,679,317 | $2,299 |
| Saline | 40,922 | 7,034 | 17.2% | $13,651,617 | $1,941 |
| Scott | 4,428 | 1,334 | 30.1% | $2,718,379 | $2,038 |
| Searcy | 3,047 | 919 | 30.2% | $1,733,097 | $1,886 |
| Sebastian | 50,467 | 12,058 | 23.9% | $25,097,548 | $2,081 |
| Sevier | 5,738 | 1,793 | 31.2% | $3,909,301 | $2,180 |
| Sharp | 7,763 | 2,104 | 27.1% | $3,935,738 | $1,871 |
| Stone | 4,283 | 1,162 | 27.1% | $2,300,141 | $1,979 |
| Union | 18,203 | 5,251 | 28.8% | $11,338,798 | $2,159 |
| Van Buren | 6,963 | 1,633 | 23.5% | $2,800,869 | $1,715 |
| Washington | 80,984 | 15,990 | 19.7% | $30,543,556 | $1,910 |
| White | 29,421 | 6,965 | 23.7% | $13,615,189 | $1,955 |
| Woodruff | 3,030 | 1,081 | 35.7% | $2,252,538 | $2,084 |
| Yell | 8,393 | 2,427 | 28.9% | $5,086,459 | $2,096 |
| **TOTAL** | **1,156,391** | **282,867** | **24.5%** | **$588,095,405** | **$2,079** |

* AACF calculations based on tax year 2006 data from the IRS's SPEC (Stakeholder, Partnerships, Education, and Communication) office in Little Rock, AR, and the Brookings Institution. Note: For maps and other data tools on the EITC in Arkansas, see AACF's online KIDS COUNT Data Center of indicators on child and family well-being: http://www.aradvocates.org

It is important to note that there are many more low-income families in Arkansas than these EITC data indicate. AACF's calculations of IRS data show that 64.4 percent of all tax returns in Arkansas were made by those with adjusted gross incomes (AGI) below $40,000, roughly twice the federal poverty level, yet only 38 percent of low-income tax filers claimed EITC.

While the total number of tax returns with an AGI of less than $40,000 is at best a very rough proxy for the number of low-income families eligible for the EITC, it suggests that many low-income taxpayers in Arkansas are not claiming the EITC, even though they may be eligible.

The potential gap in EITC eligibility versus utilization also varies widely across the state. Using the best available county-level data, Table 2 (right) lists the top 10 Arkansas counties with the lowest ratio of low-income taxpayers to EITC claims (and which may have the greatest potential for unclaimed EITC dollars).[13]

The IRS estimates that 20-25 percent of those eligible for the EITC nationwide are not claiming it. **Based on these figures, AACF estimates conservatively that Arkansas could be losing between $88.5 million to $110 million per year in unclaimed EITC benefits.[14]**

**Table 2: Top 10 Arkansas Counties with Greatest Potential for Unclaimed EITCs (Based on Percentage of Low-Income Tax Returns that Claimed the EITC)**

| COUNTY | % Low-Income Filers That Claimed EITC |
|---|---|
| Baxter | 26.7 % |
| Benton | 30.5 % |
| Cleburne | 31.0 % |
| Saline | 31.0 % |
| Marion | 31.3 % |
| Washington | 31.9 % |
| Faulkner | 32.2 % |
| Grant | 32.4 % |
| Boone | 32.8 % |
| Garland | 33.2 % |
| **State Average** | 37.8 % |

Source: AACF calculations of IRS data, TY 2006

## TAX PREPARATION FEES AND RALS ARE EATING AWAY AT ARKANSAS'S EITC BENEFITS

The EITC helps a quarter of all Arkansas tax filers living in poverty to survive each year. However, two major factors erode the value of the EITC's benefits that should be accruing to working families: high fees for tax preparation services and refund anticipation loans (RALs). In fact, these unnecessary costs threaten the economic security of all low- and moderate-income Arkansans (even those who don't claim the EITC). Working-class families, who are often desperate for cash and can be easily manipulated into using services that they may not need and can hardly afford, deserve better public and corporate policies that help protect their interests.

## VITA: A VITAL ALTERNATIVE TO COSTLY TAX PREP SERVICES

As recent events have highlighted, our federal tax code is so complicated that many of our nation's top financial experts and government leaders can't pay their taxes correctly and on time—even with the help of top-notch accounting firms. For most working families, filing income taxes on their own is just as intimidating, even if their earnings are low and their tax returns should be fairly straightforward. Since the IRS has historically audited low- and middle-class families far more often than those at the top of the income ladder, it's easy to see why most of these families pay a significant percentage of their income for professional help in filing their taxes.[15]

Most low- and moderate-income families also don't know that better options are available. According to the U.S. Treasury's 2008 survey of taxpayers with RALs, 81 percent of respondents were unaware that they would had qualified for the IRS's free tax return preparation assistance, and 85 percent said that they would have been willing to wait up to nine days to receive their tax refund directly from the IRS if they had been better informed about RALS.[16] Unfortunately, nonprofit advocacy organizations and volunteer tax preparers cannot afford to compete with for-profit tax prep services through national or state TV marketing campaigns and glossy brochures and direct mail. Therefore, the cycle of rip-offs continues each tax season

**According to AACF calculations of IRS data, 76.6 percent of all Arkansas tax filers that claimed the EITC paid a tax preparation firm to prepare their taxes in 2006.** The National Consumer Law Center (NCLC) estimates the average cost of tax preparation services to be $163 in that year.[17] Based on that average cost, AACF estimates that Arkansas taxpayers that claimed the EITC spent $35,321,774 on tax preparation fees to do so—eroding six percent of the state's total EITC dollars from the federal government. As a result, millions of our tax dollars ultimately serve as an "economic stimulus" for for-profit tax preparation companies rather than a safety net for low-income they were intended to help. When including all tax filers with AGI below $40,000 (not just those claiming the EITC), AACF estimates that **all low- and moderate-income families in Arkansas spent $77,954,098 on tax preparation fees in 2006.**

As previously mentioned, low-income taxpayers are often unaware that they can file their taxes for free through the IRS's website or get free help in person at Volunteer Income Tax Assistance (VITA) sites in their local communities or by Tax Counseling for the Elderly (TCE) volunteers. According to the IRS's local SPEC (Stakeholder, Partnerships, Education, and Communication) office in Little Rock, 39 Arkansas counties (52 percent) had at least one VITA or other taxpayer assistance site in 2009. Several local nonprofits and churches hope to expand or open new VITA sites in 2010.

**Of the 282,867 tax filers in Arkansas that claimed the EITC in 2006, only 3,807 (0.1 percent) used free tax preparation services by volunteers. Overall, 19,425 (2.6 percent) of all the 744,915 low-income tax filers in Arkansas used free tax filing services through VITA or other volunteers.**[18]

Table 3 lists the top 10 Arkansas counties with the highest percentage of low-income tax filers that paid to for tax services, as well as those with the highest percentage using free VITA tax preparation services.

### Table 3: Counties with the Highest Percentage of Low-Income Tax Filers That Paid to Have Their Taxes Prepared vs. Used Free VITA Tax Prep Volunteers

| COUNTY | % Low-Income Filers That Paid for Tax Preparation | COUNTY | % Low-Income Filers That Used Free VITA Tax Volunteers |
|---|---|---|---|
| Sevier | 79.2% | Madison | 7.8% |
| Clay | 75.9% | Garland | 7.3% |
| Scott | 76.4% | Pope | 7.2% |
| Searcy | 75.7% | Boone | 6.3% |
| Sharp | 74.9% | Sebastian | 6.2% |
| Calhoun | 74.9% | Baxter | 6.0% |
| Polk | 73.9% | Franklin | 4.6% |
| Lawrence | 74.2% | Hot Spring | 4.3% |
| Independence | 74.2% | Crawford | 4.1% |
| Howard | 74.6% | Phillips | 4.1% |
| **State Average** | **64.2%** | **State Average** | 2.6% |

Source: AACF calculations of IRS data, TY 2006

## RAPID REFUNDS: ROLLING AWAY WITH WORKING FAMILIES' MONEY

Another major threat to EITC benefits for working families and their communities is refund anticipation loans (RALs) and refund anticipation checks (RACs), also known as "rapid tax refunds." These loans are secured and repaid directly from consumers' IRS tax refunds, usually within a day or two for RALs and within 7-10 days for RACs—even though the IRS now processes refunds at almost the same speed, and its new data system will make refunds even faster in the future.[19] Hidden in the fine print of RAL and RAC applications are triple-digit annual percentage rates (APR), plus exorbitant fees, similar to those of the payday loan industry.[20] In other words, consumers pay to borrow their own money a few days early, at a cost that would make Suze Orman's head explode.

To make matters worse, the vast majority (85 percent) of U.S. taxpayers who apply for RALs have AGI of $38,348 or less (approximately twice the federal poverty line), and nearly two-thirds (63 percent) of RAL consumers were EITC recipients (even though EITC recipients made up only 17 percent of individual taxpayers in 2007, and thus are greatly overrepresented for RAL usage). Nationwide, IRS data shows that 46.3 percent of EITC recipients obtained either a RAL or RAC in 2007; in other words, "about half of EITC recipients pay part of their publicly funded benefits to a bank to obtain a tax-related financial product."[21]

Since 2002, the National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) have issued annual reports on the RAL industry's history of preying on the working poor.[22] Many other researchers have found misleading or deceptive practices by for-profit companies offering tax preparation services and RALs, including the federal government. The U.S. Government Accountability Office (GAO) (2008) conducted "mystery shopper" testing of tax preparers in several states. One-third of preparers sampled were located in businesses that target low-income customers, such as check cashers, payday loan vendors, rent-to-own stores, and pawn shops, and many made "free" tax prep contingent upon buying their goods and services. For example, one car dealer promised free tax preparation if customers used their tax refunds as a down payment on a car.

Nevertheless, many working families feel that they have no choice but to use a RAL if they are working at a low-wage job and only surviving paycheck to paycheck. Having limited assets or a spotty credit history prevents many families from qualifying for regular bank accounts or credit cards for emergency use. For these families, a RAL can mean the difference in making the rent and sleeping in their car or at a homeless shelter—especially if they are hit with a job loss or work reduction. Plus, when a multi-millionaire like Magic Johnson is advertising RALs for Jackson Hewitt, it's easy to see why many people trust tax preparation services to help them get a little of their hard-earned money back quickly.[23]

## HOW MUCH DO ARKANSAS FAMILIES AND COMMUNITIES LOSE TO RALS?

About 8.67 million U.S. taxpayers (one out of every 15) had a RAL in 2007, slightly down from 9 million in 2006 and a high of 12.4 million in 2004.[24] Fortunately, NCLC has found that the use of RALs is trending downward nationally.[25] It remains to be seen whether the current recession will reverse this trend, as more families face a credit crunch and are more anxious for their paychecks than ever before.

The average RAL fee was $107.50 in 2007, down from $163 in 2006. NCLC estimates that U.S. taxpayers paid close to $1 billion in RAL fees in 2007. Based on IRS data, NCLC estimates that about $567 million in EITC benefits were wasted on RAL fees in 2007. EITC recipients who got RALs paid an additional $996 million in tax preparation fees beyond RAL fees, resulting in a total drain of $1.56 billion on the EITC program. Table 4 shows the average amounts that taxpayers spent on tax preparation and RAL fees in 2007, as well as the estimated total amount of money drained from local communities across the country.

Although the available national data on RALs is not perfect, estimates can provide a good idea about the extent of the personal financial damage they are causing in Arkansas: According to NCLC's 2008 report, taxpayers paid an average of $100 to open a RAL in 2006 (not includ-

**Table 4: Average Refund Anticipation Loan (RAL) and Tax Preparation Fees in 2007 in U.S.**

| Type of Fee | Average Cost to Taxpayers | Estimated Drain on EITC Program |
|---|---|---|
| RAL loan fee[1] | $107.50 | $523 million |
| Add-on fees[2] | $40.00 | $44 million |
| **Total RAL fees** | **$147.50** | **$567 million** |
| Tax preparation fee | $183.00 | $996 million |
| **Total Cost of RAL and Tax Preparation Fees** | **$330.50** | **$1.56 billion** |

Source: NCLC, 2008. Notes: [1]This is the fee for the "dummy" bank account that RAL users are required to open to receive their tax refund from IRS to repay the RAL. [2] This estimate includes many companies' "add-on" charges for services such as "document preparation" and "e-filing."

ing extra "add-on" fees required by approximately 25 percent of RAL companies), and the average tax preparation fee was $163. Using NCLC's figures and the latest available data from the IRS, AACF estimates that taxpayers claiming the EITC paid $16,275,200 in RAL fees and $35,321,774 in tax preparation fees in 2006.

**In total, all low-income tax filers in Arkansas (those with AGI below $40,000, not just those claiming the EITC) spent an estimated $21,688,000 in RAL fees and $77,954,098 in tax preparation fees in 2006, for a total of $99,642,098.**

Table 5 lists the top 10 counties with the highest percentage of tax filers using RALs in 2006. All but one are located in the Delta, and all have far higher levels of poverty and African-American residents than the rest of the state.

**Table 5: Arkansas Counties with the Highest Use of Refund Anticipation Loans (RALs) in 2006**

| | % of Total Tax Returns with RALs | % Total Population in Poverty | % Total African-American Population |
|---|---|---|---|
| Phillips | 41.8% | 37.2% | 59.0% |
| Crittenden | 39.8% | 25.7% | 47.1% |
| St. Francis | 39.2% | 32.6% | 49.9% |
| Mississippi | 36.5% | 28.2% | 32.7% |
| Lafayette | 36.1% | 24.6% | 36.5% |
| Hempstead | 35.4% | 21.5% | 30.4% |
| Desha | 35.4% | 26.6% | 46.3% |
| Lee | 34.7% | 31.8% | 57.2% |
| Chicot | 34.6% | 32.4% | 54.0% |
| Jefferson | 34.5% | 25.0% | 49.6% |
| **State Average** | **22.3%** | **17.6%** | **15.7%** |

Source: AACF calculations of data obtained from the Internal Revenue Service's SPEC, Tax Year 2006, and the National Consumer Law Center (NCLC); the U.S. Census Bureau's 2007 Small Area Income and Poverty Estimates (SAIPE) and 2000 Decennial Census. AACF's estimates are based on an average tax preparation fee of $163 and an average RAL cost of $100 in 2006 (NCLC, 2008).

### RALS AND TAX PREP FEES HIT MINORITIES THE HARDEST

Although data on the race of individual taxpayers in Arkansas is not available, it is possible to approximate the impact of RALs and tax prep fees on low-income, African-American families by combining IRS data with demographic data from the U.S. Census Bureau. AACF's analysis found that the use of RALs and for-profit tax preparers in Arkansas counties was highly correlated with the number of African-American residents in that county. Of Arkansas counties with the highest percentages of African-Americans, 78.9 percent of tax filers used RALs, compared to the state average of 22.3 percent. In these communities, the vast majority (83.3 percent) of low-income tax filers who paid for tax preparation services were sold RALs, compared to the state average of 45.3 percent.

### HOW DOES YOUR COUNTY FARE IN EITC BENEFITS?

To see how your county fares in terms of EITC claims and the use of paid tax preparers and refund anticipation loans (RALs), see Arkansas Advocates for Children and Families' (AACF) website at www.aradvocates.org.

**BY THE NUMBERS: EITC AND RALS USE IN ARKANSAS**

- 22.3% of all tax filers in Arkansas had RALs in 2006.
- 29.1% of low-income filers had RALs.
- 57.5% of tax filers claiming the EITC had RALs.
- 45.3% of low-income filers who used for-profit tax preparers were sold RALs.
- 75.1% of EITC filers who used for-profit tax preparers were sold RALs.

## CONCLUSION AND RECOMMENDATIONS

The EITC is one of our nation's most successful public policies in helping move people out of poverty, and Arkansas's local economies depend a great deal on the $588 million spent by those claiming the federal EITC. Our communities need to make sure that all working families know about the EITC and that they should file their taxes every year, even if they earn so little that they have no federal tax liability.

The drain of RALs and for-profit companies' tax preparation fees on the state's EITC benefits is clear. These fees are ripping off thousands of Arkansas's low- and middle-income working families, even those who do not claim the EITC. Below are a few recommendations for how the state can prevent this massive loss of revenue and help working families achieve economic self-sufficiency:

**Hold tax preparation companies accountable.** The IRS may soon begin cracking down on deceptive practices of tax preparation services.[26] Until then, shady companies are free to continue preying on those who can least afford it.

**Ban exorbitant RAL fees at the federal and state levels.** Consumer advocates helped push the state to crack down on payday lenders in recent years. It's time to do the same for predatory tax preparers and RALs. A recent law sponsored by state Rep. Darrin Williams (Act 1402) will help increase the transparency of RAL fees for consumers, but the state must take further steps.

**Litigation in several states has helped curb the abuses of predatory lenders and RAL companies in recent years (see NCLC's reports).** However, the Second Circuit Court of Appeals issued a major decision in 2008 that may hamper the ability of states to further regulate RALs. The Court declared that federal banking law trumped Connecticut's cap on RAL interest rates at 60 percent APR. As a result, only the U.S. Congress can change the limit to RAL fees. In the meantime, NCLC has drafted a model RAL law for usurious practices that states can still regulate: http://www.consumerlaw.org/issues/refund_anticipation/index.shtml

**Partner state agencies and community services to advertise VITA and the EITC.** There is currently no central location or website in Arkansas to find information about EITC, VITA sites' free tax preparation services, and the dangers of and alternatives to RALs. Using the county-by-county data that is available along with this report, the state of Arkansas should adopt a comprehensive state-level EITC outreach campaign, targeted to specific counties, that would enable it to maximize EITC utilization and reduce the use of RALs and tax preparer fees for low-income families. The plan would best be implemented in conjunction with local partners. For example, Arkansas's central tax agency, the Department of Finance and Administration (DFA), should work with community organizations such as the Central Arkansas Development Council (CADC) and other state agencies such as the Department of Workforce Services (DWS) to help publicize these resources. New money from the federal stimulus package could be used to help launch a taxpayer education campaign or create new VITA sites or coordinated resources. The state's new poverty task force (created by Act 722) could also give momentum to this effort.

**Expand VITA sites.** VITA sites provide a much-needed service to working class families in Arkansas. However, they can be expensive and time-consuming to operate and often struggle to find enough highly-trained people who are willing to volunteer. State and federal funding and corporate and non-profit investment in creating and expanding VITA sites will save Arkansas money in the long run.

**Expand alternatives to RALs.** Working families need other short-term loan options without the triple-digit interest rates of RALs. Organizations such as the Southern Good Faith Fund (SGFF) know what works, but we still need banks to make it happen.[27]

**Permanently extend the EITC increase in the federal stimulus package.** These changes only apply to 2009 and 2010 tax returns. Congress should permanently extend these EITC improvements in the FY 2010 budget.

**Enact a state EITC.** It is time for Arkansas to join the growing number of other states in enacting a state-level EITC. The current recession may linger for several months or even years, making a state EITC more critical than ever. Twenty-four other states—including our neighbors, Louisiana and Oklahoma, have found ways to make it happen, and so can Arkansas.

## ENDNOTES

[1] See Arkansas Advocates for Children and Families' brochure: "Rules of the Game: An Advocate's Guide to the Arkansas Tax and Budget System," (2009): http://www.aradvocates.org/_images/pdfs/Advocate%27s%20Guide%20FINAL%20WEB.pdf

[2] AACF (2008). "Giving credit where it's long overdue: Enacting a state earned income tax credit in Arkansas." Paychecks and Politics, Issue No. 42: http://www.aradvocates.org/_images/pdfs/P&P_EITC.pdf; Holt, S. (2006). "The earned income tax credit at age 30: What we know." Washington, DC: The Brookings Institution.

[3] Center on Budget and Policy Priorities (CBPP) (2009). "Policy basics: The earned income tax credit": http://www.cbpp.org/cms/index.cfm?fa=view&id=2505

[4] Internal Revenue Service (2009): http://www.eitc.irs.gov/central/abouteitc

[5] Internal Revenue Service (IRS) (2009). "EITC thresholds and tax law updates": http://www.irs.gov/individuals/article/0,,id=150513,00.html

[6] Koulish, J., & Levitis, J. (2008). "State earned income tax credits: 2008 Legislative update." Washington, DC: CBPP: http://www.cbpp.org/files/6-6-08sfp1.pdf

[7] See AACF (2008).

[8] For more information about ARRA and the EITC, see Kneebone's "Economic Recovery and the EITC: Expanding the Earned Income Tax Credit to benefit families and places" (2009), The Brookings Institution: http://www.brookings.edu/papers/2009/0129_eitc_kneebone.aspx

[9] Berube, A., Park, D., & Kneebone, E. (2008). "Metro raise: Boosting the Earned Income Tax Credit to help metropolitan workers and families." Washington, DC: The Brookings Institution; Berube, A. (2006). "Using the Earned Income Tax Credit to stimulate local economies." The Brookings Institution; Federal Reserve Bank of Atlanta (2006). "EITC boosts local economies"; Spader, J., Ratcliffe, J., & Stegman, M.A. (2005). "Transforming tax refunds into assets." Chapel Hill, NC: Center for Community Capitalism.

[10] Nagle, A., & Johnson, J. (2006). "A hand up: How state earned income tax credits help working families escape poverty in 2006." Washington, DC: CBPP: http://www.cbpp.org/files/3-8-06sfp.pdf

[11] AACF analysis of TY 2006 data provided by the IRS's SPEC (Stakeholder, Partnerships, Education, and Communication) office in Little Rock, AR.

[12] Note that these figures do not reflect the overall EITC take-up rate; data is not available on the total number of individuals

eligible for the federal EITC in each county in Arkansas. In other words, actual utilization rates may be much higher. See Alan Berube's backgrounder, "Earned Income Credit Participation—What We (Don't) Know" (The Brookings Institution, 2004) for more information about the methodological challenges in calculating the uptake rate of the EITC.

[13] It is possible that some of these counties may have lower utilization rates because they have higher numbers of retirees and college students, who may be ineligible for the EITC. More data collection and analysis from the IRS is needed to determine the most accurate utilization rate.

[14] For more information on AACF's methodology, see The Brookings Institution's "EITC Interactive: User Guide and Data Dictionary": http://www.brookings.edu/metro/EITC/EITC-Data.aspx#eligible

[15] Johnson, D.C. "IRS audits middle class more often, more quickly." *The New York Times*, April 16, 2007.

[16] U.S. Treasury Inspector General for Tax Administration. (2008). "Many taxpayers who obtain refund anticipation loans could benefit from free tax preparation services:" http://www.ustreas.gov/tigta/auditreports/2008 reports/200840170fr.pdf

[17] Wu, C.C., & Fox, J. A. (2009). "Big business, big bucks: Quickie tax loans generate profits for banks and tax preparers while putting low-income taxpayers at risk" (p. 12). The National Consumer Law Center (NCLC) and the Consumer Federation of America. See also the 2007 and 2008 reports: http://www.consumerlaw.org/issues/refund_anticipation/index.shtml

[18] Contact AACF or see our website for county-level data on the EITC, RALs, or VITA in Arkansas: http://www.aradvocates.org

[19] For more information on the technical differences between RALs and RACs, see NCLC (2008). For simplicity's sake, AACF's paper refers to both financial products as RALs.

[20] See AACF's previous research on the predatory lending industry: "Payday Lenders in Arkansas: Renting Out-of-State Bank Charters Help Evade State Law" (2005); "Alternatives to Payday Loans in Arkansas," (2005); "Existing Options for Arkansas Consumers: Avoid the Payday Loan Debt Trap" (2006).

[21] NCLC (2008).

[22] NCLC (2008).

[23] "'Magic' tax refund loans prey on working poor, critics say." *San Francisco Chronicle*, March 29, 2009.

[24] NCLC (2008).

[25] See also Berube, A., & Kornblatt, T. (2005). "Step in the right direction: Recent declines in refund loan usage among low-income taxpayers." Washington, D.C.: The Brookings Institution.

[26] "IRS Weighs New Rules on Tax Preparers," *Wall Street Journal*, June 4 2009.

[27] See the Southern Good Faith Fund: http://www.southerngoodfaithfund.org/assetbuilders.php

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