How You Can Help Working Families: Recommendations to Address Costly Tax Preparation

The tax code is a powerful source of help for millions of low-income families with children. The Earned Income Tax Credit (EITC), enacted in 1975, is the largest and most effective national anti-poverty program. As a result of the EITC, working families have earned billions of dollars in needed assistance.

DEFINING THE EARNED INCOME TAX CREDIT (EITC) FOR WORKING FAMILIES

The EITC is a federal tax credit for taxpayers who work but earn low wages. The credit also helps offset the disproportionate share of their income that low-income families spend on payroll, sales and excise taxes. It is "refundable" which means that workers who do not own income tax and file a tax return can receive a check from the IRS.

The value of the EITC depends on the number of children in a family and the amount of income earned through work. During the 2004 tax season, the EITC is worth up to $4,204 for workers who earn up to $33,692 ($34,692 if married filing jointly) and have two or more qualifying children, and up to $2,547 for workers who earn up to $29,666 ($30,666 if married filing jointly) and have one qualifying child. Workers without children can receive up to $382.

To claim the EITC and other tax credits, taxpayers need to complete and file their federal and state income taxes—a task that can be very complex. The laws and procedures that govern this area of the tax code in particular are very complicated, and often change from one year to the next. In addition, many low-income families face language and literacy barriers. Consequently, it is not surprising that a high percentage of low-income families hire a professional to prepare their taxes. Of taxpayers claiming the EITC, 62 percent, go to a paid preparer. Tax return preparers are responsible for 68% of the errors or over claims on the EITC.[1]

> **STATE EITC**
>
> A number of states have enacted a state EITC that supplements the federal credit and works as a rebate for state taxes paid by low-income families.
>
> Seventeen states offer a state EITC, which is often a percentage of the federal credit. In addition local governments in Montgomery County, MD, and Denver, CO, offer their own version of EITCs. EITCs have been enacted in states controlled by both Republicans and Democrats and have been supported by both business groups and social service advocates. See www.stateeitc.org for more information on state EITCs.

RESEARCH SHOWS HOW THE EITC HELPS WORKING FAMILIES

One study found that 83% of families said that paying bills such as utilities and rent was one of the top three priorities for their EITC money, and 74% of families said that purchasing basic household commodities and clothing was a priority. In addition, 50% of the families were going to save at least part of their EITC money, and 16% were going to pay tuition.[2] In sum, earned income tax credits help low- to moderate-income families meet their basic immediate needs and make ends meet while investing in the local economy.

THE FULL VALUE OF THE PROGRAM IS NOT REACHING WORKING FAMILIES

Low-income taxpayers lost over $1 billion in loan charges and fees related to preparation of their tax returns in 2002. These costs can include tax preparation, documentation preparation or application handling fee, electronic filing fee and a Refund Anticipation Loan (RALs). The RALs are

[1] Opportunities Exist to Improve the Administration of the Earned Income Tax Credit: June 2003 Inspector General for Tax Administration (reference number: 2003-40-139)

[2] Smeeding, T.M., Phillips, K.R. & O'Connor, M. The EITC: Expectation, Knowledge, Use and Economic and Social Mobility. National Tax Journal,53. 2000.

loans secured by a tax-payers' tax refund, including the EITC. (*More on RALs later.)*

In healthy middle and upper income communities, consumers have access to loans and credit cards at competitive rates, and branch offices of mainstream banks and savings and loans offer a full array of banking services. By contrast, in many low-income minority communities the absence of capital can deter entrepreneurs and limit the expansion of neighborhood businesses. Low-income consumers are forced to patronize fringe financial service providers that charge exorbitant rates for personal loans and limited banking services[3].

REFUND ANTICIPATION LOANS CUT EITC BENEFITS

Refund Anticipation Loans (RALs) are loans, typically bought by consumers at income tax preparation firms like H&R Block and Jackson Hewitt Tax Service. Consumers pay a fee to get their anticipated tax refund before the government actually sends them a check. Approximately 12.1 million RALs were taken out during the 2001 tax season at an average cost of $75 per taxpayer with an average annual percentage rate (APR) of 143.6 percent.[4]

By purchasing a RAL, the tax filer assigns the proceeds of his/her tax refund to the preparer's bank partner, and the preparer arranges a loan for the taxpayer in the amount of his/her refund, net of fees for tax preparation and the loan itself. These products are familiarly referred to as "rapid refund" or "fast cash" loans. Typically, tax preparers and their bank partners charge a fee for the loan that is based on the size of the anticipated refund, plus additional flat "documentation" or "loan preparation" fees.

According to an H&R Block release, the company served more than 18.7 million clients in the US in 2003. Providing approximately 4.5 million RALs to H&R block clients in 2003 and another 1.6 million H&R block clients chose a refund anticipation check, which allows them to pay the bank a setup fee to receive the money without taking out a loan.

The bank makes the loan available to the taxpayer within 1 to 2 days, and the IRS typically delivers the taxpayer's refund to the bank within 10 days. For this short-term loan, the taxpayer often pays fees in excess of $100 (in addition to the fees they pay to have their taxes prepared and filed), and incurs an implicit annual interest rate on the loan of 250 percent or higher.

RALS TARGET HIGH POVERTY AREAS

Recent research has shown that low-income taxpayers who claim the EITC represent the majority of the marketplace for RALs. The product's popularity varies substantially across the U.S., but the most recent IRS figures indicate that 43 percent of all refund recipients who claimed the EITC in tax year (TY) 2001 purchased RALs.

A new report, co-authored by the Brookings Urban Center and the Progressive Policy Institute, details for the first time, how the use of tax preparation services and "fast cash" refund loans is concentrated among working poor families and neighborhoods. In the Washington, D.C. area, the report finds that a typical recipient of the federal EITC pays roughly $200 for commercial tax preparation, electronic filing and a "rapid refund" loan. The authors estimate that nearly $2 billion in EITC refunds nationwide were diverted to pay for these services and products in 1999, with more than half of all low-income families purchasing refund loans in some of the nation's largest cities and suburbs. The percentage of EITC earners who purchase rapid refunds was highest in metropolitan areas in the South (46%), followed by the Midwest (43%), the Northeast (28%), and the West (25%). Eight of the top ten central cities by percentage of EITC earners with RALs were in the south[5].

Children's Defense Fund (CDF) looked at RAL patterns in New York City, Anderson County Tennessee and a five-county area in South Carolina as part of planning for CDF's own benefits outreach project. In New York City there was a significantly higher percentage (33) of EITC filers with RALs where the neighborhood

[3] Enterprise Foundation. 1999. Building Individual Assets; Individual Development Accounts (IDA's) and Community Development Financial Institutions.
[4] http://www.consumerlaw.org/initiatives/refund_anticipation/content/2003_RAL_report.pdf

[5] Sources: Brookings "Using EITC Date – A Guide" and "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC." RAL statistics based on 2001 EITC returns can be found at: http://apps89.brookings.edu:89/eitc/eitc.jsp

poverty rate was at or above 30 percent verses a much lower percentage (19) where the neighborhood poverty rate was below 30 percent. (See Figure 1)

Anderson County Tennessee is an example of a southern county with a relatively little concentration of poverty and yet with a high percentage of EITC filers with RALs. Note that in the one zip code with a greater than 20 percent poverty rate the percentage of EITC filers with RALs was substantially higher than in the other five zipcode areas higher (58 percent verses 45 percent). (See Figure 2)

The five counties in the South Carolina study include Marlboro, Charleston, Lexington, Richland, and Sumter. The results show a high percentage of RALs in each county in zip codes where the poverty rate is 20 percent or higher (in the aggregate, 67 percent verses 55 percent). (See Figure 3)

The CDF regional office in Minnesota has done a similar analysis in Minnesota, which also shows a higher percentage of RALs in higher poverty neighborhoods.

Figure 1

Are Refund Anticipation Loans concentrated in New York City's poorest neighborhoods?

	Number of EITC Filers	Number of EITC Filers with RALs	Percent with RALs	Number of Zipcodes
Neighborhood Poverty Rate				
Below 30 percent	290,900	56,069	19%	80
30 percent or more	263,753	86,408	33%	32

Figure 2

Are Refund Anticipation Loans concentrated in Anderson County (TN)'s poorest neighborhoods?

	Number of EITC Filers	Number of EITC Filers with RALs	Percent with RALs	Number of Zipcodes
Neighborhood Poverty Rate				
Below 20 percent	3,703	1,660	45%	5
20 percent or more	634	367	58%	1

Figure 3

Are Refund Anticipation Loans concentrated in the 5-County Area’s (SC) poorest neighborhoods?

	Number of EITC Filers	Number of EITC Filers with RALs	Percent with RALs	Number of Zipcodes
Neighborhood Poverty Rate				
Below 20 percent	58,789	32,418	55%	47
20 percent or more	26,188	17,559	67%	19

Among zipcodes with full IRS and poverty date available. IRS data for 2001; Census 2000 date for 1999. Calculations by the Children’s Defense Fund.

THE IRS MAKES RALS A SURE BET

The IRS reduces the risk that lenders take on RALs by providing them with a Debt Indicator (DI) on all IRS e-file acknowledgments. The DI informs the lender whether or not an applicant owes federal or state taxes, child support, student loans, or other government obligations, and this assists the tax preparer in ascertaining the applicant's ability to obtain their full refund so that the RAL is repaid. Thus, the excessively high interest rates for RALs are not justifiable when the IRS lowers the risk of the loans by providing the DI service.

In 1995, the use of the DI service was suspended because of massive fraud in e-filed returns with RALs. After the program was discontinued, RAL participation declined. The use of the DI service was reinstated in 1999 and fees rose significantly from 2000 to 2001. Efforts such as Senate bill S 685, the Low Income Taxpayer Protection Act of 2003, would terminate the DI service provided by the IRS.

THE APPEAL OF RALS AND WHAT TAXPAYERS AREN'T TOLD

Many low-income families may feel they have little choice but to take out a RAL. First, many are unlikely to have $100 on hand to pay for tax preparation fees. In setting up the loan, the commercial tax preparers deduct these fees first, relieving the families from needing to find alternative resources. Secondly, and probably more significantly, RALs enable families to access the amount of money they expect from their refunds within 48 hours, rather than having to wait 1 to2 weeks for the IRS to process their returns. This wait could last 6-8 weeks if the family does not file electronically and does not have a bank account to accept an electronic transfer of the refund. Indeed, many low income families lack bank accounts. According to the Federal Reserve, one out of four families with incomes less than $25,000 do not have one of any kind[6].

Many of these fees can be reduced or eliminated for families, enabling families to benefit from the full value of their EITC. Tax payers are often not told that the fees associated with taking the refund anticipation loan is avoidable.

[6] Kennickell, A.B., Starr-McCluer, M., & Surette, B.J. Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances. Federal Reserve Bulletin, January 2000.

Determining the total cost of a RAL is difficult. For example, the web sites of the largest national tax preparation companies advertise the availability of refund anticipation loans, but do not offer any information regarding fees and interest rates. One of the web sites indicates that the loan fee and annual percentage rate (APR) will "be disclosed on your disclosure statement or RAL check stub," but presumably a family would not see the RAL check stub until after they had committed to taking out the RAL[7].

In Minnesota, law limits APRs on consumer loans to 21.75 percent. However, RAL lenders circumvent state usury laws because they are nationally-chartered banks and thus only subject to federal regulation; and there is very little federal regulation in this area.

DISTURBING POINTS ABOUT THE RAL

- RALs enable families to access the amount of money they can expect from their refunds (minus the loan fees and finance charge) within 48 hours. However, it only takes the IRS 10 days, on average, to process an electronically filed return and then electronically deposit the refund into a bank account. It is likely – and anecdotal evidence suggests – that many families are unaware of how short this turnaround time is for the IRS.
- Because the RAL is a loan, they can actually leave a family in greater financial crisis. Usually, a RAL is paid off once the IRS processes the tax return and transfers the funds. However, if the IRS denies part of the refund for any reason or even withholds it temporarily for audit purposes (which is very likely to happen more frequently with EITC returns this tax season), interest continues to accrue and the family is responsible. Given their real financial needs, it is unlikely that EITC families budget for this possibility. There is also ample anecdotal evidence that some families, especially those with limited English proficiency, do not fully comprehend they are

[7] http://www.hrblock.com;taxes/doing_my_taxes/products/instant_ral.html

taking out a loan. Ironically, families could end up in debt due to their efforts to claim earned income tax credits intended to assist them in becoming more financially secure.

- Research documents that commercial tax preparers target low-income neighborhoods for their services. Neighborhoods across the nation with high percentages of EITC filers have 50 percent more electronic tax filing and preparation services than neighborhoods with low percentages of EITC filers. A study by the National Consumer Law Center (NCLC) found that RALs for the average tax refund amount carried annualized interest rates averaging 222.5%, and that the poorest taxpayers and especially those qualifying for the government's Earned Income Tax Credit were the biggest victims. Clearly, the collective economic impact of RALs is higher in these poverty-stricken areas of the state.
- Most consumers do not need instant refunds, and waiting a few more days for a direct deposited tax refund to arrive is clearly superior to taking a very high-cost short-term loan. Taxpayers can receive their refunds in an average of 10 days from the IRS if they file electronically and use direct deposit.[8]

HOW YOU CAN HELP MINIMIZE EXTRANEOUS COSTS FOR FAMILIES

Open a Bank Account

Many low-income clients who lack bank accounts find that RALs are the only way to electronically file a return and receive their refunds quickly. Tax filers can get a refund for free within just days if they file electronically with the IRS. Some choose the refund anticipation loans because they do nothave a bank account, which is required to get the quickest return, and many want the money even sooner.

According to the *Center for Law and Human Services* more than 10 million households in the United States do not have accounts at traditional financial institutions. These individuals are termed the "unbanked." The unbanked pay more for check cashing and other routine financial transactions and face difficulty in establishing a credit history.[9] Providing banking accounts to low-income clients can be profitable. A Chicago pilot program assisted 202 households in opening low-cost accounts at Shore Bank. The program brought initial deposits of $127,000 in one year from 89 account holders, 60% of which were unbanked when they opened the account.

Two Banking Options

- *Electronic Transfer Account (ETC)*
An ETA is a low-cost account for recipients of Federal payments designed by the U.S. Department of the Treasury. Generally anyone who receives Federal government payments including Social Security Supplemental Security Income (SSI), Veterans Benefits, Civil Service Wage Salary or Retirement Payments Military Wage Salary or Retirement Payments Railroad Retirement Board Payments, DOL/Black Lung can open an ETA. Not all banks, savings and loans, or credit unions offer the ETA. To locate a local institution, go to the ETA website at http://www.eta-find.gov/SearchZip.cfm **or** the Department of Treasury website at www.fms.treas.gov/eta
- *First Accounts*
First Accounts provides financial resources to develop and implement programs to expand access to financial services for low- and moderate-income individuals who currently do not have an account with an insured depository institution or an insured credit union. The website provides a list of organizations that obtained funding to operate these programs: http://www.ustreas.gov/offices/domestic-finance/financial-institution/fin-education/firstaccounts

Having a bank account enables people freedom to manage their funds directly. Of course, they can write checks directly too. They would also be able to eliminate the costs associated with check cashing outlets and utilize direct deposit services. Direct

[8] For more information on the dangers of RALs click on "Refund Anticipation Loan" on NCLC's Internet home page -- www.consumerlaw.org

[9] Money in the Bank: How Federal Tax Refunds and Credits Help Households Become Bank Users by Shore Bank and the Center for Law and Human Services.

deposit means they would not have to pay for unnecessary fee services provided by tax preparers.

Check cashing outlets can charge anywhere from 3 to 7% for their service. If the average benefit for a family of four is $2,953, then, at the lowest level, (3%) it would cost the family $88.60 to use the services of a check cashing place.

Encourage Tax Payers to Wait Longer

Taxpayers can eliminate the cost of the RAL by simply waiting a little longer. The wait becomes a few weeks instead of two days, but it can save upwards of $100. If taxpayers are well informed, they may choose to wait.

Lifting families out of poverty is as much about how much income they have coming in as it is about what they pay for services and their ability to build assets.

Use Free Filing Services

EITC recipients can utilize the free tax preparation and e-filing through Free File, which is located on www.IRS.gov. EITC claimants also are urged to consider electronic filing, especially through Free File, which offers free tax preparation and e-filing to millions of taxpayers. Using E-filing can help reduce math errors that can delay a refund. Taxpayers who e-file and use direct deposit will receive their refund in two weeks or less.

Free Tax Preparation

The best way to save money is to go to a free tax preparation service.

Working families should be able to obtain the full value of their tax returns to purchase necessary household items, pay off debt, buy new clothes, or put money in a savings account.

Many non-profit are stepping up efforts to help taxpayers with free tax preparation services. These sites work in collaboration with the IRS and can be found at convenient locations in communities during tax season.

Some are:

1. The Children's Defense Fund www.childrensdefense.org also see http://www.childrensdefense.org/benefits_outreach.php
   25 E Street NW, Washington, DC 2001 • (202) 662-3645

2. The Center on Budget and Policy Priorities – http://www.cbpp.org/EITC2004/index.html
   First Street, NE, Suite 510 • Washington, DC 20002 • (202) 408-1080

3. The Center for Economic Progress http://www.centerforprogress.org/programs_free.html 29 E. Madison, Suite 910 • Chicago, IL • 60602 (312) 252-0280

4. For more information on locations of these sites, go to the IRS website at: http://www.irs.gov/individuals/article/0,,id+107626,0.html

IRS NEEDS TO STEP UP TO THE PLATE

According to the National Taxpayer Advocate's Annual Report to Congress for 2003, additional outreach and education about EITC is needed for taxpayers and practitioners to improve taxpayer awareness, reduce taxpayer confusion, reduce practitioner tax return errors, and improve compliance with the EITC. Millions of people who are eligible for the EITC never claim it, while the IRS receives a multi-billion dollar volume of excessive or erroneous EITC claims for other taxpayers.

The IRS concentrates more resources on the compliance aspect of erroneous claims (80 percent) than on increasing participation and filing correct claims through outreach and education (12 percent).

The IRS must do more if it hopes to reach its EITC participation rate goal of 80 percent for TY 2004.

NATIONAL TAXPAYER ADVOCATE'S (NTA) ANNUAL REPORT TO CONGRESS FOR 2003

Each year, the NTA publishes a comprehensive report, which includes detailing the "Most Serious Problems" faced under the tax code, and makes "Legislative Recommendations." This report is often the basis for legislative proposals and action. Two "serious problems" sited in the report pertain to EITC: navigating the IRS and earned income tax non-filers.

Serious Problems

- Navigating the IRS

Improvements are needed in intranet tools, the toll-free telephone system, and the website. IRS has made changes helpful to its employees but not to taxpayers. Tools developed by the IRS must also benefit taxpayers.

The NTA recommends that IRS: provides taxpayers and their representative with a concise easy to use IRS directory; establish toll-free numbers or a suitable alternative for overseas taxpayers; and provide one-stop taxpayers service.

- Earned Income Tax Non-filers

The NTA recommends that IRS identify the demographic characteristics of non-filers and work with Low Income Taxpayer Clinics to formulate market-specific strategies for those populations.

Currently, non-filers are more likely to be either: taxpayers with a very low income; taxpayers with a history of public assistance receipt; larger families; and workers without children. Hispanic parents whose first language is not English are also less likely to file. California, Texas, New York, and Florida accounted for 40 percent of non-filers and 44 percent of EITC dollars not claimed in a 2002 IRS study.

Legislative Recommendations

Of the 1.2 million known tax return preparers, approximately 300,000 to 600,000 are not regulated by any licensing entity or subject to minimum competency requirement. Tax return preparation now occurs in pawn shops, furniture rental stores, check-cashing and convenience stores, and car dealerships with refunds applied to the purchase of merchandise.

Penalties for regulated preparers are often small and are considered a cost of doing business. Adequate enforcement mechanisms that include audits and penalty collection are not in place. In calendar years 2001 and 2002, the IRS assessed preparer penalties totaling $2.4 million and collected $291,000, only 12 percent of the amount assessed.

The IRS tax year 1999 EITC compliance study identified returns with $11 billion in overclaims and $710 in underclaims of the credit. Preparers prepared over 63 percent of those returns. In TY 2001 preparers prepared over 68 percent of all EITC returns.

Electronic Return Originators (EROs), person or entities that originate electronically filed returns, are subject to minimum background and tax checks. The IRS has no statutory authority to impose monetary penalties against repeat offenders of ERO program requirements. Ninety percent of electronically filed fraudulent returns involve a RAL product.

The NTA is concerned that the IRS, in its drive to meet Congress' requirement of 80 percent electronic filing by 2007, has not sufficiently researched the consequences of some of its initiatives on tax compliance.

The NTA **recommendations** aim to impose an effective oversight and penalty regime for return preparers and others associated with the commercial tax preparation sector. These include:

- Establish a registration, examination, certification, and enforcement program for federal tax return preparers.
- Increase penalties for violations including understatements due to unrealistic positions, for negotiation of a refund check, and with respect to certain requirements for preparation of income tax returns.
- Impose a tiered penalty structure for violation of the EITC due diligence requirements, and require the due diligence certification to be signed by the return preparer and attached to the taxpayer's income tax return.
- Impose a civil penalty against a tax return preparer who, by reason of intentional misstatement, misrepresentation, fraud, or deceit causes a taxpayer a tax liability attributable to the EITC.
- Impose and/or increase certain penalties.
- Require the Secretary, in consultation with the NTA, to study the impact that cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance, and report the results to the appropriate congressional committees within one year of establishment.

The NTA also makes two **administrative recommendations:**

- Include a checkbox on all returns and other submissions that require a preparer signature and the preparer to enter his or her category of return preparer (e.g. attorney, CPA, enrolled agent, or unenrolled preparer).
- Develop a simple, easy-to-read pamphlet that explains to taxpayers their right to refuse to consent to disclosure or use of information by return preparers, and what constitutes a valid consent under the regulations.[10]

LEGISLATIVE CHANGES ARE NEEDED TO:

1. **Simplify the rules and process.**
   Working families should be able to complete their own taxes, without having to pay for professional assistance. Federal and state laws, especially those that govern working family's income taxes, need to be simplified, and federal and state tax credit programs need to be coordinated.

2. **Ensure that free tax assistance for EITC families is available, accessible, and well-publicized.**
   Free tax assistance for low-income families is available at Volunteer Income Tax Assistance (VITA) sites, for example, in many Minnesota communities, but very few people know this. In fact, these sites serve less than five percent of the EITC-eligible taxpayers. The community groups and non-profit organizations like AccountAbility Minnesota that operate many of these sites need help. Different levels of government, employers, foundations, churches, and other community groups can all provide financial assistance, make site locations available, donate computers for electronic filing, help recruit volunteers, and conduct outreach with potential EITC families. EITC families should also be made aware that they can complete and file their own taxes for free through the website: www.taxfreedom.com.

3. **Strengthen consumer protection and education.**
   There is extremely little regulation of tax preparers—they are not even required to have a high school education. Yet, they are entrusted with personal information and expected to stay abreast of many complex tax laws. The federal and state governments could do more to regulate and monitor the practices of paid preparers as well as the national banks with which they partner to offer RALs. Last year Minnesota passed a law that created some standards of conduct for tax preparers and tightened disclosure laws for RALs. Families need to understand what they can expect of their tax preparer, as well as the drawbacks and hidden costs of RALs. (For information on the new standards and disclosures, see the "2003 Consumer Law Summary" available on the Legal Services Advocacy Project's website: www.lsapmn.org.)
4. **Federal and State government should do more to regulate policies on short term loans**
   While this is a complicated issue, the government should step up to the plate and regulate the short-term loan policies. The current, weak and non-existent policies enable low-income working families to pay considerably more for services than those able to utilize mainstream services. Taking advantage of families in this manner should not be accepted.
5. **Connect more low-income families with financial institutions and increase their financial literacy.**
   Having a tax refund electronically deposited directly into a bank account speeds up the turnaround time significantly, but one out of four families with incomes less than $25,000 do not have bank accounts. Recent efforts to partner free tax assistance with financial institutions are proving successful.

CURRENT PROPOSALS

LOCAL: Philadelphia Proposes RAL Legislation

Philadelphia Councilwoman Marian B. Tasco is considering proposing legislation that would regulate the highly profitable RAL industry in the city. Critics of RALs, including Tasco, say the practice is predatory lending that targets low-income neighborhoods where many people are eligible for the federal government's earned income

[10] For a copy of the full report go to the IRS website at http://www.irs.gov/newsroom/article/0,,id=119518,00.html

tax credit, or EITC. "That money is siphoned out of the community, and nine times out of 10, it is siphoned out of low-income and working-class families," said Cherelle L. Parker, a spokeswoman for Tasco. "It is siphoned out by the high fees of the refund anticipation loans."

Parker said that Tasco is working with the legislative drafting committee on legislation that could be introduced as early as next month. On November 20, 2003, Tasco introduced a resolution in City Council asking state officials and legislators to "take appropriate action" to ensure that the practice is legal. However, Parker said the councilwoman is now considering local legislation to regulate the practice.

Model refund anticipation loan legislation drafted by the National Consumer Law Center caps fees on refund anticipation loans at 36 percent (on an annual percentage basis). It also requires that tax preparers disclose information about refund anticipation loans, including the fees, examples of the interest rate and the risks of the loans.

STATE: SIX STATES AND ONE CITY ACT

According to the GAO, six states (California, Illinois, Minnesota, North Carolina, Oregon, and Wisconsin) and one city (New York City) have laws that provide paid preparers oversight or consumer protections regarding RALs. These laws range from requiring registering or licensing of paid preparers to requiring disclosure statements for RALs. For example, the City of New York requires a separate disclosure statement for RAL agreements that must be provided in English or Spanish.[11]

FEDERAL: SENATE LEGISLATION

S 685, The Low Income Taxpayer Protection Act of 2003 introduced by Senator Bingaman (NM) and Akaka (HI), proposes requiring the licensing and registration of paid preparers and RAL providers. The proposal requires preparers to abide by the rules of conduct that currently govern practitioners and contains provisions aimed at discouraging the use of RALs, including regulating the fees charged for RALs. Unfortunately, these protections were lost when other components of the bill were folded into the Good Government Act S 882. Also lost was the provision to terminate the debt indicator program described above. Language for this bill can be found at http://thomas.loc.gov/

THE DEPARTMENT OF TREASURY

On January 13, 2004 the Treasury Department announced proposals to simplify some tax procedures. In the proposal were some items covering the EITC and CTC to:

1. **Simplify the Earned Income Tax Credit (EITC**). The proposal would: (1) allow some estranged spouses who live with their children to claim the EITC if they live apart from their spouse for the last six months of the year; (2) allow certain taxpayers who live with children but do not qualify for the larger child-related EITC to claim the smaller EITC for very low-income childless workers; and (3) eliminate the investment income test for taxpayers who are otherwise EITC eligible.
2. **Make Computing the Child Tax Credit Easier.** Taxpayers are required to satisfy income tests to determine the refundable child tax credit and the EITC. The requirements are different for the two credits. As a result, taxpayers must calculate their income twice. In addition, the credits have different US residency requirements. The additional child tax credit also requires families with three or more children to compute the amount of the credit twice to determine the higher amount. The proposal would use the same income and residency tests for the refundable child tax credit and the EITC and would provide one computation to determine the credit amount.
3. **Make Uniform Various Definitions of a Qualifying Child.** Families with children may be eligible for reduced taxes or for refundable credits through the dependent exemption, the head of household filing status, the child tax credit, the child and dependent care tax credit, and the earned income tax credit (EITC). Each of these tax benefits uses a definition of a qualifying child that is different in some way from the others. In addition, for some of these benefits, the taxpayer must provide over half the costs of supporting the child (the “support test”). Having different definitions of a qualifying child for different tax benefits is confusing for taxpayers and leads to errors. In

[11] GAO report to the Committee on Finance, U.S. Senate, “Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS Is a Challenge”, October 2003.

addition, the support test, when it applies, is difficult to understand and requires taxpayers to keep extensive records. The proposal would make the definition of a qualifying child the same for each of the five child-related tax benefits. In addition, the support test would be eliminated. Instead, taxpayers would be required to live with the child for over half the year, which is a much simpler test to apply.[12]

EITC RESOURCES

1. Pathways to Getting Ahead – aids young adults as they start on the path to building assets. The booklet is intended for young adults (ages 17 to 30) to spur thinking about the importance of asset building. The booklet is available on the web at: www.centeronhunger.org/adi/Asipubs.html or call 800-409-1333 email – publiccomm.affairs-bos@bos.frb.org
2. The New America Foundation Asset Building Program is an online clearinghouse of ideas, policies, and programs to broaden ownership in the US and around the world. Visit http://www.assetbuilding.org
3. EITC eligibility rules can be found in Fact Sheet 2004-8, in Publication 596 and through links at 1040 Central on http://ww.IRS.gov. For tax preparers, there is a new EITC information kit at http://www.irs-eitc.info/preparer/ http://www.irs-eitc.info/preparer/ and a new EITC tool kit in Publication 3107E. Reminder: military families may also qualify for EITC because supplemental payments and combat pay are exempt from the income calculations.

The mission of the Children's Defense Fund is to Leave No Child Behind® and 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 the help of caring families and communities. CDF began in 1973 and is a private, nonprofit organization supported by foundations, corporation grants and individual donations and does not accept government funds.

CHILDREN NEED ADEQUATE FAMILY INCOME IF THEY ARE TO MEET THEIR MOST BASIC NEEDS, FROM DIAPERS TO DOCTORS TO HEALTHY FOOD AND SAFE HOUSING.

Whether a child will flounder or flourish can hinge on things that money buys: good quality child care, eyeglasses to read the chalkboard, a little league fee, a musical instrument. Or simply the peace of mind that lets parents create a warm and nurturing family life free from worries about eviction or hunger.

Yet more than 12 million children are poor and millions more live in struggling families with incomes just above the official poverty line. Giving children economic security means providing stronger tax credits for low-paid working families and a more reliable safety net when jobs fall through. It also means making more effective use of available programs and ensuring that families have access to the tax credits and food, health, and other public benefits that already exist.

TAX AND BENEFITS OUTREACH

The Children's Defense Fund Tax and Benefits Outreach effort seeks to ensure children and working families receive tax assistance, such as the Earned Income Tax Credit and the Child Tax Credit, as well as other benefits for which they are eligible. We can lift significant numbers of children and their families out of poverty with benefits that are already available. For more information about the Children's Defense Fund Tax and Benefit Outreach effort call Deborah Ortiz at 202-662-3645. Or, go to http://www.childrensdefense.org to find a free tax preparation site in your city.

[12] For the full text of the proposals go to: http://www.ustreas.gov/press/releases/js1096.htm