



WISCONSIN COUNCIL ON

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Raising Voices to Make Every Kid Count

Maximizing Tax Refunds

**Putting More Money in Workers' Pockets and Into Local Economies
By Decreasing Reliance on Refund Anticipation Loans**

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Executive Summary

Analysis of the most current available IRS data reveals that over 130,000 Wisconsin residents paid an average of \$250 in 2004 to receive their tax refunds a few days to a couple of weeks earlier than they otherwise would, through refund anticipation loans (RALs), for a total direct cost to Wisconsin tax filers of \$32.5 million.

It has long been recognized that, like check-cashing and rent-to-own stores, paid tax preparers target their RAL offerings and marketing in low-income neighborhoods. In such neighborhoods there are typically high numbers of working-but-poor residents who qualify for the Earned Income Tax Credit (EITC) – and who therefore are likely to receive a tax refund. Low-income workers are also less likely to have bank accounts, making the temporary account set up to receive the loan quickly through direct deposit even more attractive.

This strategy has been effective, as over 22 percent (63,767) of EITC recipients received their refunds in 2004 through these high-cost, short-term loans (as compared to 5.1 percent of *all* tax filers utilizing RALs). For the largest paid tax preparer chains, RAL fees have become a significant source of revenue in recent years.

The millions siphoned off by largely out of state companies – some of which simply set up shop in low-income neighborhoods at tax time – would otherwise make it into our working families' budgets and be spent primarily at local businesses.

Research has shown that a transfusion of cash into low- and middle-income neighborhoods can have an “economic multiplier” effect of 1.5 to 2. This means that for every dollar spent, there is typically between \$1.50 and \$2.00 of resulting economic activity (because money spent ensures that goods are produced, wages paid, taxes collected, and so on). For example, in the Milwaukee metropolitan area, the 49,596 total RALs taken out in 2004 carried a direct cost to tax filers of over \$12.4 million, and indirect costs of between \$18.6 and \$24.8 million in lost economic activity. Statewide, the economic loss stemming from RALs totaled between \$48.8 and \$65 million in 2004.

Simply noting the high costs associated with RALs is likely not enough to counter the slick advertising campaigns engaged in by paid tax preparers at tax time and the allure of “instant cash.” The following steps, however, taken by state officials in conjunction with community and financial partners, could help decrease the attractiveness of and reliance on RALs, and could put more hard-earned money into the pockets of working Wisconsin residents and into local economies.

Recommendations:

- Increase the availability of free tax preparation assistance for low-income tax filers, focusing efforts on low-income neighborhoods.
- Set specific goals for increasing the number of tax filers utilizing free tax assistance sites (either statewide or in highly affected areas).
- Engage and encourage businesses to reach out to employees regarding free tax preparation options and the high costs of RALs.
- Expand current efforts to increase financial accounts among low-income residents.

RAL Use in Wisconsin

Costly for Workers and Communities

Refund anticipation loans are a financial product sold by many professional tax preparers for a fee. The loans are secured by the tax filer’s expected refund, which is then assigned to a bank – either part of that same firm or one partnering with the tax preparation firm. Additional fees are levied for tax preparation and check cashing. A temporary account is set up at the bank to receive the refund from the government. The loan is paid to the tax filer within a day or two, and the refund arrives at the bank within a week or two.

RAL costs are significant according to the National Consumer Law Center and the Consumer Federation of America. Including tax preparation and check cashing, RAL costs average \$250.ⁱ The short duration of the loan coupled with the high RAL costs (as a percentage of the average return) translates into percentage interest rates into the hundreds.

The money spent on tax preparation and loan fees can equal a week’s pay for some, and several weeks of groceries for most. The benefit of the RAL itself is minimal, with the loan recipient receiving their refund just a few days to a couple of weeks earlier than they otherwise would.

Despite these high costs, 130,003 RALs were secured in 2004 (for tax year 2003) by Wisconsin tax filers.ⁱⁱ This marks an increase of 7,000 RALs from the previous spring, though it is still lower than the high of 148,703 taken out in 2001.

At an average of \$250, direct costs to consumers totaled \$32.5 million. These costs are born by the low-income workers and their families, and there are also wider economic impacts felt by everyone in the community, from the lost infusion of cash coming from tax refunds.

Table 1. Direct and Indirect RAL Costs by Metropolitan Area, Tax Year 2003			
Metro Area	# of RALs	Direct Costs	Total Economic Costs
Green Bay	6,205	\$1,551,250	\$2,326,875 – \$3,102,500
Eau Claire	3,100	775,000	1,162,500 – 1,550,000
Janesville/Beloit	5,116	1,279,000	1,918,500 – 2,558,000
LaCrosse	2,231	557,750	836,625 – 1,115,500
Madison	10,894	2,723,500	4,085,250 – 5,447,000
Milwaukee	49,596	12,399,000	18,598,500 – 24,798,000
Sheboygan	2,254	563,500	845,250 – 1,127,000
Wausau	2,251	562,750	844,125 – 1,125,500

A transfusion of funds into a community is known to have an “economic multiplier” effect. Simply put, money spent ensures that goods will continue to be produced, wages paid, and taxes

collected. The economic multiplier of funds flowing into low- and middle-income communities has been shown to be between 1.5 and 2. For every dollar spent, between \$1.50 and \$2.00 of total economic activity occurs.

For example, then, in the metro Milwaukee area, while consumers paid \$12.4 million in direct costs, there were also indirect economic costs to the region of between \$18.6 and \$24.8 million, from the foregone economic activity. The direct and indirect costs stemming from RAL use for other major metropolitan areas around the state are shown in Table 1.

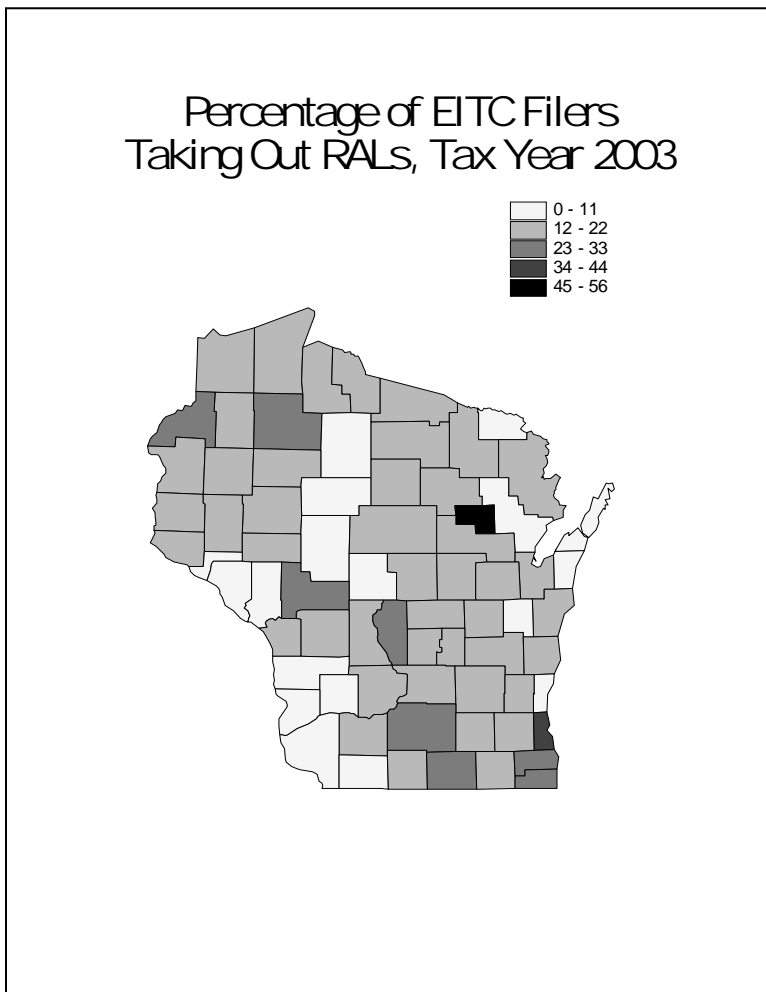
RAL Use Highly Concentrated

Even a cursory examination reveals that RAL use is highly concentrated in a small number of communities around the state. Of the state’s 72 counties, only 10 were at or above the statewide average rate of RAL use for earned income tax credit (EITC) filers, as shown in Table 2 below.

Table 2. Wisconsin Counties where RAL use (among EITC claimants) Is at or above State Average (22.5%), TY 2003

County	% of EITC Returns with RAL
Menominee	56.1
Milwaukee	35.9
Racine	32.0
Kenosha	29.2
Sawyer	28.7
Rock	27.8
Burnett	23.6
Jackson	23.3
Adams	22.6
Dane	22.5

The map below also illustrates this point, showing the vast majority of counties with low or very low RAL use rates – those lightly shaded areas, and very few – the darker shaded counties, exhibiting high or extremely high rates.



The concentration of RAL use in the state is not random. There is a strong connection between low-income status (as evidenced, for example, by high EITC recipient numbers) and high RAL use rates.

The EITC is a refundable tax credit available to low-income workers (“refundable” means that even if a tax filer does not have any income tax liability, they can get the credit; it does not merely offset taxes owed).ⁱⁱⁱ

Table 3 below lists those communities with the highest RAL usage. The top 10 zip code areas all also exhibit extremely high EITC recipient rates. Statewide, this phenomenon is made even clearer. While only 5.1 percent of tax filers statewide received their refunds through RALs in

2004, 22.5 percent of EITC recipients took out RALs (accounting for about half (63,767) of all the RALs taken out in the state that year (130,003)).

Research by the Brookings Institution has shown that zip codes with high EITC use have fifty percent more electronic tax preparations service storefronts per filer than low EITC use zip codes.^{iv} Paid tax preparers have admitted to targeting high EITC communities in the past, and the continued concentration of RAL usage in high EITC areas is evidence that practice continues.

Table 3. Top 10 Zip Code Areas by Percent of EITC Returns with RALs, and Percent of All Returns with EITC, TY 2003 (limited to areas with at least 30 EITC returns)				
Zip Code	City	County	% of EITC Returns w/RALs	% of All Returns w/EITC
54135	Keshena	Menominee	56.1	38.0
54150	Neopit	Menominee	56.0	48.0
53206	Milwaukee	Milwaukee	51.8	53.7
54861	Sanborn	Ashland	48.6	48.7
53205	Milwaukee	Milwaukee	46.3	55.1
53224	Milwaukee	Milwaukee	45.5	24.6
53210	Milwaukee	Milwaukee	45.4	39.1
53404	Racine	Racine	45.3	26.9
53404	Caledonia	Racine	45.1	26.9
53208	Milwaukee	Milwaukee	45.1	32.3
Statewide			22.5	11.3

A significant portion of the RALs in the state are taken out in the Milwaukee area, and a number of zip code areas within the City of Milwaukee are routinely at the top of the list for high RAL use. The Milwaukee metro region as a whole saw nearly 50,000 of the state's 130,003 RALs in 2004 taken out within its confines.

Native American Communities Continue to be Targeted

Another aspect of RAL use exposed by this brief examination is the extraordinarily high RAL use on and near tribal lands. As shown in Table 1 above, Menominee County's RAL use rate of over 56 percent is over 20 percentage points above that of the county in second position, Milwaukee.

Table 3 also illustrates this point, with Keshena, Neopit, and Lac du Flambeau on the top 10 list. Other Indian reservation communities or those nearby with high RAL rates over the last several years have been Couderay in Sawyer County, Odanah in Ashland County, and Hertel in Burnett County.

Recently, as an example of how groups can respond to the high costs of and better alternatives to RALs, a group of Menominee High School students held a poster contest highlighting the pitfalls of RALs in their community. Because the data coming from the IRS lags by a couple of years, we will have to wait to see the impact those and other recent efforts have had on RAL use there.

The highly concentrated nature of RAL use in the state speaks largely to how paid tax preparation firms are targeting their marketing and outreach for RALs in low-income communities. It also suggests that any effort to increase the awareness of the high costs of RALs should also be strategically targeted with available resources focused on those same communities.

Why Pay to Get Your Own Money?

Any attempt to decrease tax filer's reliance on high-cost RALs must begin with an understanding of what drives the market for that product. The allure of RALs is easy to understand, despite the high costs.

RALs are aggressively marketed to low-income workers. Tax preparation storefronts have become a common site in low-income neighborhoods throughout the state, along with rent-to-own and check cashing outfits. As mentioned earlier, research by the Brookings Institution has shown that paid tax preparers exist in low-income neighborhoods in high numbers. By their own admission, the large tax preparation chains target low-income communities because of the likelihood of the residents there being eligible for the EITC.

Secondly, the prospect of receiving a tax refund quickly is attractive when the amount of money expected is a significant sum for the filer and immediate expenses are looming. If a tax filer has a savings or checking account, he or she could receive their refund quickly by having it directly deposited. The fact is, however, that many of those seeking the EITC do not have bank accounts, making the RAL especially attractive to them. Furthermore, the fees for tax preparation and filing and an RAL are often deducted automatically from the refund, with nothing owed by the consumer "upfront."

Another factor is that the tax code is complicated. Despite recent efforts to simplify tax forms, many tax filers – unaware perhaps of the availability of free tax preparation assistance – likely see paid tax preparers as the only safe option.

How Taxes are Filed in Wisconsin

In 2004, nearly 67 percent of EITC recipients in Wisconsin used a paid professional tax preparer to file for their refund. 1.6 percent utilized a voluntary tax preparer, and 0.5 percent utilized free file, the no-cost online filing option.

Table 4. Top 25 Zip Code Areas by Percent of EITC Returns with RALs, and by Filer Type, TY 2003						
Zip Code	City	County	Percent of EITC Returns with:			
			RALs	Paid Prep	Vol Prep	Free File
54135	Keshena	Menominee	56.1	75.8	0.0	0.0
54150	Neopit	Menominee	56.0	78.0	0.0	0.0
53206	Milwaukee	Milwaukee	51.8	76.7	5.8	0.5
54861	Sanborn	Ashland	48.6	70.3	0.0	0.0
53205	Milwaukee	Milwaukee	46.3	73.0	8.0	0.0
53224	Milwaukee	Milwaukee	45.5	75.2	2.9	0.6
53210	Milwaukee	Milwaukee	45.4	73.9	5.3	0.9
53404	Racine	Racine	45.3	71.5	2.2	0.0
53404	Caledonia	Racine	45.1	71.7	2.1	0.0
53208	Milwaukee	Milwaukee	45.1	72.0	6.6	0.6
53725	Madison	Dane	45.1	66.7	0.0	0.0
53212	Milwaukee	Milwaukee	44.7	70.5	6.5	0.7
53233	Milwaukee	Milwaukee	44.1	67.5	7.8	0.0
53403	Racine	Racine	43.2	69.8	2.0	0.5
53403	Mt. Pleasant	Racine	43.1	69.6	2.1	0.5
53225	Wauwatosa	Milwaukee	43.0	74.2	3.0	0.7
53225	Milwaukee	Milwaukee	42.8	74.2	2.9	0.9
53209	Brown Deer	Milwaukee	42.1	72.1	4.6	0.7
53209	Glendale	Milwaukee	42.0	72.0	4.8	0.6
53209	Milwaukee	Milwaukee	42.0	71.9	4.7	0.7
54538	Lac du Flambeau	Vilas	41.7	79.2	0.0	0.0
53218	Milwaukee	Milwaukee	41.1	73.1	4.0	0.6
53216	Milwaukee	Milwaukee	40.5	71.2	5.1	0.4
53204	Milwaukee	Milwaukee	39.9	73.6	8.7	0.3
53141	Kenosha	Kenosha	37.0	71.7	0.0	0.0
Statewide			22.5	66.7	1.6	0.5

Table 4 above lists the top zip code areas once again, by RAL use by EITC recipients. A number of things stand out. There are a number of Milwaukee zip code areas that have a significantly higher rate of voluntary tax preparer use, than the statewide average. This may be due to existing efforts to reach out to low-income communities by community groups, the Department of Revenue, and others. Given the high numbers of those still using the paid preparers, however, even in these same areas, focusing outreach efforts on these communities, setting benchmarks for improving the numbers of filers using alternatives to RALs, and then measuring the level of success of those efforts would be a good way to target additional efforts.

Conclusion and Recommendations

RALs are a high-cost loan targeted to low-income workers, many of whom have a hard-earned tax refund coming due to the Earned Income Tax Credit. RALs diminish the impact of the EITC by siphoning millions of dollars away from low-income workers every year. The overall economic impact is even greater. The following recommendations could help reduce the growing reliance on RALs and put more money back into workers' pockets and into local businesses.

1. Increase the availability of free tax preparation assistance for low-income tax filers, focusing efforts on areas with high EITC eligibility.

The Internal Revenue Service trains VITA volunteers (Volunteer Income Tax Assistance), but these locations serve a very small percentage of eligible tax filers every year. Likewise, many Low-Income Taxpayer Clinics (LITCs) exist around the country, at law schools, accounting schools, technical colleges and so on. Community organizations can take the lead in sponsoring a VITA or LTC site, or in spreading the word of their availability through an outreach campaign. Local governments could also play a role by dispersing information regarding these free tax preparation services available in their respective communities.

2. Set specific goals for increasing the number of tax filers utilizing free tax assistance sites (either statewide or in highly affected areas).

Information is available by zip code area regarding how tax filers submit their taxes, for instance the numbers of those using a paid preparer and those using a voluntary tax preparation service. The state should set goals for increased use of VITA and other free tax preparation sites, either at a zip code level, concentrating again on those areas with highest RAL use, and/or at a statewide level.

3. Engage and encourage businesses to reach out to employees regarding the availability of free tax preparation sites and the high costs of RALs.

Employees that are able to take advantage of existing work supports, such as the EITC, are more stable and likely to remain with an employer longer. Businesses have much to gain, then, from sharing information with their employees regarding the availability of VITA sites as well as the high costs associated with RALs.

4. Expand Current Efforts to Increase Savings Accounts Among Low-Income Residents

One of the primary reasons low-income workers turn to RALs is their lack of a savings account. If a tax filer has a bank account he or she can have their refund directly deposited and receive it in a matter of days instead of weeks. There are several barriers, however, to possessing a savings account, including poor – or nonexistent – credit history and lack of understanding of the usefulness in having an account. Distrust of financial institutions such as banks also runs strong in many communities.

Not only does having a savings account make RALs less attractive, they bring about other benefits as well, including the building of credit history and making it easier for account holders to save money over time.

Footnotes:

ⁱ This average comes from a typical RAL loan fee of \$75, an electronic filing/administrative fee of \$75 and a tax preparation fee of \$100. Exact fees will differ by tax preparer.

ⁱⁱ All EITC and RAL data presented in this report are from tax returns filed in 2004 (tax year 2003) unless otherwise noted, and can be found on the Brookings Institution website at www.brookings.edu/metro/eitc. This interactive website contains a database from which tables can be created for all states and by zip code, municipality, county, and metropolitan area. There is also information on how tax filers filed their taxes, as presented in Table 4.

ⁱⁱⁱ In 2004, 284,021 Wisconsinites received a total of \$453 million in EITC federal refunds (for an average of about \$1,600). Wisconsin has, as many states do, its own EITC available to the state's low-income workers. In the same year, Wisconsin invested over \$73 million in its EITC, bringing the total state and federal commitment to the EITC to \$526 million.

^{iv} *The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC*, by Berube, Kim, Forman, and Burns, May 2002, available at <http://www.brookings.edu/metro/publications/berubekimeitcexsum.htm>.