



Texas Economy Got \$4 Billion Boost from the Earned Income Tax Credit
Over 2 Million Workers Benefited, yet \$1.2 Billion in Credits Went Unclaimed

Last year, more than two million Texas workers claimed over \$4 billion in federal dollars for tax year 2003 through the federal Earned Income Tax Credit (EITC). The EITC not only boosts the earnings of low-wage workers and stimulates the Texas economy; it also provides an excellent opportunity for working families to save for the future. Although outreach and free income tax assistance have improved awareness of the program, the Texas economy and working families lost out on nearly \$1.2 billion in unclaimed EITC payments last year. Not only that, but over two-thirds of EITC filers used commercial tax filing services or “Refund Anticipation Loans”—whose fees slice into low-income Texans’ hard-earned refunds. This Policy Page analyzes the latest EITC data for Texas, provides a link to local EITC data at the workforce board and county level, and offers recommendations to maximize the benefit of this important tax credit for working families.

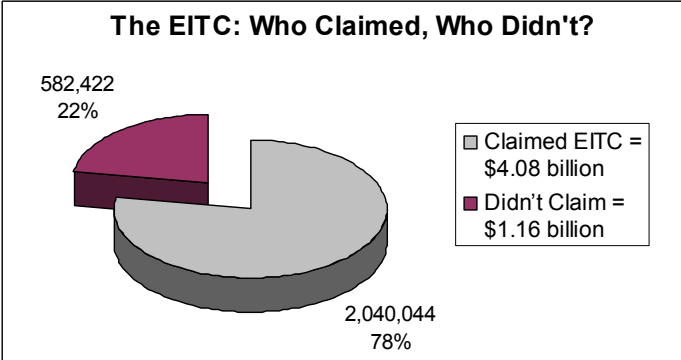
WHAT IS THE EARNED INCOME TAX CREDIT?

The Earned Income Tax Credit provides eligible workers with low or moderate income a rebate of all federal income taxes deducted from their paychecks the previous year. In 2004, low-income workers with children are potentially eligible for a credit up to \$4,300, depending on their earnings and number of dependents. Workers between the ages of 25 and 64 without dependents are eligible for a credit up to \$382, depending on their earnings. For more information about who’s eligible for the EITC, see our Policy Brief at http://www.cppp.org/brf_eitc05.pdf.

WHO CLAIMS IT, WHO DOESN'T?¹

In tax year 2003, over two million Texas workers claimed \$4 billion through the EITC—10.9 percent of the \$37.5 billion in EITC refunds claimed nationwide. The average EITC refund in Texas was \$2,002.

Although more and more Texans claim the EITC each year, 22.2 percent of eligible tax filers—582,422 workers—did not claim their refunds in 2003. As a result, these low-income Texans and the economy lost out on \$1.2 billion (based on the average EITC refund).



The average rate of unclaimed EITC refunds nationwide was 23.8 percent in 2003, representing approximately \$11.8 billion. Texas’ share of unclaimed EITC dollars nationwide was 9.9 percent.

The data on the amount of unclaimed EITC refunds in 2003 **only capture those taxpayers who filed a tax return, but did not claim the EITC**; they do NOT include potentially eligible workers who do not file a tax return. Therefore, the data may underestimate both the number of workers who miss out on the EITC and the amount of unclaimed EITC refunds.

Note: Local data on the EITC in Texas are available for local workforce development regions and by county. To view and download these data, visit CPPP’s web site at <http://www.cppp.org/products/policyanalysis/eitc.html>.

¹ EITC data are from an analysis of IRS data by the Administration for Children & Families, U.S. Dept. of Health and Human Services.

IRS AND STATE EITC OUTREACH

IRS Outreach: Run by the IRS, the Volunteer Income Tax Assistance (VITA) Program offers free tax preparation to low-and moderate-income (\$36,000 and below) taxpayers. Local organizations sponsor the volunteers, who are trained by the IRS to prepare basic tax returns and determine whether taxpayers are eligible for the EITC and other tax credits. VITA sites are generally located at community and neighborhood centers, libraries, schools, shopping malls, and other convenient locations. In addition to free tax return preparation assistance, many sites also offer free electronic filing (e-filing). Individuals who use the e-file program receive their refunds twice as fast as filing paper returns—even faster if they have their refunds deposited directly into their bank account. *To find a VITA site in your community, call 211.*

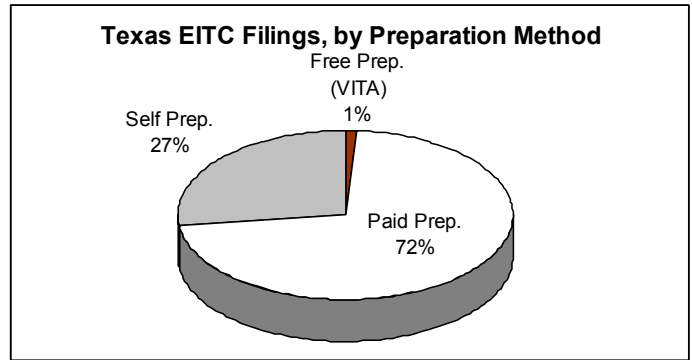
State EITC outreach: Several state agencies conduct EITC outreach with their clients. The **Texas Health and Human Services Commission (HHSC)** provides information about the EITC at the local offices where people sign up for Food Stamps, Medicaid, and TANF cash assistance. The **Texas Workforce Commission (TWC)** provides information about the EITC to 28 local workforce development boards and encourages them to educate their clients (primarily Food Stamp and TANF cash assistance recipients) about the EITC. Recently, the Governor awarded \$500,000 in grants to expand TWC's "Earn it. Claim it. Save it." campaign from three to seven local workforce boards. This campaign raises awareness of the EITC among employers and working families and offers tax preparation assistance and financial literacy classes. The **Texas Comptroller of Public Accounts** is responsible for coordinating state outreach efforts on the EITC.

USE OF PAID TAX PREPARERS AND REFUND ANTICIPATION LOANS

Despite the expansion of free tax preparation and ongoing outreach about the EITC, the vast majority of low-income filers in Texas use paid tax preparers for their returns.

In 2003, 72 percent of EITC filers in Texas used paid tax preparers. Assuming each of these tax filers paid \$120—the average tax preparation fee nationwide—then an estimated \$140 million was lost on tax

preparation fees in 2003, or 3.4 percent of total EITC claims.²



Some tax preparers also offer "Refund Anticipation Loans" (RALs), that charge taxpayers additional fees to immediately receive their EITC refunds. The interest rate on these loans can be as high as 700 percent over the life of the loan—depending on the amount and the length of the loan and the fee charged by the lender. If the IRS determines that the refund is lower than anticipated, the taxpayer also bears the risk of having to pay back the difference at the same exorbitant interest rate.

The Brookings Institution estimates that over 900,000 tax filers in Texas used RALs in 2002—46 percent of total filers that year.³ In some large ZIP codes, more than half of tax filers used a RAL—compared to 35 percent nationwide. The rate of RAL use among taxpayers who didn't file for the EITC (i.e., higher-income taxpayers) was much lower, only 10%.⁴

The percentage of Texas EITC filers that use RALs is high compared to other states. Of the 10 most populous states, Texas had the second highest rate of RAL use in 2002, behind Georgia. At 46.2 percent, Texas's rate of RAL use was 22.7 percentage points higher than California's, the state with the lowest rate

² Average fee is from H&R Block, *Q4 2002 H & R Block Earnings Release* Conference Call, June 12, 2002, reported in *Picking Taxpayers' Pockets, Draining Tax Relief Dollars: Refund Anticipation Loans Still Slicing Into Low-Income Americans' Hard-Earned Tax Refunds*, The National Consumer Law Center's and Consumer Federation of America's 2005 Refund Anticipation Loan Report, by Chi Chi Wu, NCLC, and Jean Ann Fox, CFA (contributing author), January 2005. CPPP used this average fee to estimate the total EITC dollars lost to tax preparation fees in 2003.

³ The Brookings Institution, Metropolitan Policy Program, *Tax Year 2002*. Interactive data download available at <http://www.brookings.edu/metro/eitc.htm>.

⁴ "Keeping What They've Earned: Working Texans and Tax Credits," Children's Defense Fund – Texas, February 2005.

among these 10 states. The rate of RAL use for these states is:⁵

Georgia: 52.1%
Texas: 46.2%
Ohio: 39.5%
Illinois: 37.6%
Florida: 36.2%
New Jersey: 33.8%
Michigan: 33.4%
Pennsylvania: 31.3%
New York: 25.9%
California: 23.5%

Several factors contribute to the higher-than-average use of RALs among low-income Texas taxpayers: the state's large population of low-income residents with limited English proficiency; our low literacy rate; low financial literacy among low-income residents; a large "unbanked" population (22 percent of low-income Texans don't have a bank account);⁶ aggressive marketing of RALs by tax preparers; limited state regulation of RALs; and limited access to free tax preparation.

In 2004, an average RAL cost \$90. Based on this amount, RALs drained an additional \$84.4 million from Texas EITC recipients last year.⁷

When combined, the fees charged by paid tax preparers and RAL lenders drained an estimated \$224 million from taxpayer EITC refunds in 2003—5.5 percent of total EITC claims.

POLICY RECOMMENDATIONS

Texas can build on its commitment to maximize the benefits of the EITC for working families and the state by expanding outreach and combining these initiatives with increased financial education for low-income taxpayers.

Texas should also consider ways to encourage low-income workers to save their EITC refunds. The EITC

⁵ Op. Cit., Brookings Institution

⁶ The Brookings Institution, Metropolitan Policy Program, "Banking the Poor: Policies to Bring Low-Income Americans Into the Financial Mainstream, Michael S. Barr, September 2004.

⁷ This was the loan fee in 2002 for a \$2,000 to \$5,000 RAL from Household Bank, reported in NCLC/CFA's 2004 RAL report. CPPP's estimate of the amount of EITC dollars lost to RAL fees in 2003 is based on the percentage of Texas EITC filers who used RALs in 2002 applied to the number of filers in 2003, multiplied by the average RAL in 2004.

provides a huge infusion of cash for many households, presenting an enormous opportunity for low-income families to save. However, low-income people often lack easy access to savings products (such as IRAs, 529s, Roth IRAs), so this money is often spent rather than saved. **Individual Development Accounts (IDA)** offer a way for states to help low-income individuals build their assets. These interest-bearing accounts help low-wage workers to save for a specific purpose—usually a home, education, or to start a small business—by matching their savings with public or private funding.

There are currently more than 20 IDA programs in Texas. In his fiscal 2006 budget, President Bush has proposed \$25 million nationwide to match state and local dollars spent on IDAs and a tax credit for employers who contribute to IDAs. These initiatives could assist Texas in expanding the number of IDAs available to low-wage workers.

PENDING STATE LEGISLATION

Texas lawmakers have introduced several pieces of legislation that would expand EITC outreach, regulate the use of RALs, and provide financial education to low-income consumers.

- **HB 630**, by Rep. Mike Villarreal, would expand EITC outreach at HHSC by requiring its staff to provide referrals to VITA sites and tax forms to potentially eligible clients of health and human services programs.
- **HB 398**, also by Rep. Villarreal, would limit RAL fees and require mandatory disclosures on RAL applications.
- **HB 492**, by Rep. Beverly Wooley, would require financial education in public schools.

ADDITIONAL RESOURCES

Visit CPPP's web site to learn more about our **Family Asset Building Project**, an effort to help low-and moderate-income families build financial security through assets, savings, and financial literacy: <http://www.cppp.org/products/policyanalysis/eitc.html>

Download an EITC outreach toolkit from the Center on Budget and Policy Priorities: <http://www.cbpp.org/eic2005/index.html>

Download an EITC outreach toolkit designed for use by employers from Corporate Voices for Working Families:

<http://www.cvworkingfamilies.org/toolkits/eitc/2005index.html>

Use the IRS' interactive "EITC Assistant" to find out if you're eligible for the EITC:

<http://www.irs.gov/individuals/article/0,,id=130102,00.html>

The Children's Defense Fund has a great summary of Refund Anticipation Loans, available at

http://www.childrensdefense.org/benefits/ral/Ral_TX.pdf

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