Center on Urban & Metropolitan Policy
The Brookings Institution
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"...proliferating tax preparation services and products in low-income neighborhoods are diverting significant EITC dollars away from working families."

The Price of Paying Taxes:
How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC

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Findings

A study of how low-income taxpayers collect tax refunds, including an analysis of the spatial distribution of commercial tax preparers and "rapid refund" loans in the nation's 100 largest metropolitan areas, finds that:

- **In the Washington, D.C. area, taxpayers claiming an Earned Income Tax Credit (EITC) of $1,500 spend, on average, more than 10 percent of this amount on tax preparation, electronic filing and a refund loan if they use a commercial tax preparer.** One local preparer's prices were typical of those for national chain preparers: $60 for preparation of a federal return with the EITC, $34 for a state return, $20 for electronic filing, and up to $90 for a refund loan, for a total of $204.

- **The nation's largest commercial tax preparation service and tax refund lenders earned $357 million from "fast cash" products in fiscal year 2001.** This more than doubled the approximately $138 million these companies earned on similar products in fiscal year 1998.

- **Electronic tax filing and preparation services cluster in neighborhoods where large numbers of families claim the EITC.** High-EITC zip codes are home to 50 percent more electronic tax preparation services per filer than low-EITC zip codes. Cities and suburbs in the U.S. South and West are home to low-income neighborhoods with the highest concentrations of tax preparers.

- **An estimated $1.75 billion in EITC refunds in 1999 was diverted toward paying for tax preparation, electronic filing and high-cost refund loans.** In 1999, nearly half of the $30 billion in EITC claimed nationwide was refunded through high-priced loans.

I. Introduction

In 2002, the federal Earned Income Tax Credit (EITC) will provide more than $30 billion in refundable credits to low-income working families. The credit represents one of the nation's largest—and most effective—anti-poverty policies, as it lifts an average of 5 million Americans above the poverty line each year. Previous research has demonstrated the large economic impact that the EITC makes in cities and metropolitan areas throughout the U.S.[2] For instance, Los Angeles County received nearly $1.3 billion in EITC refunds in 1998, and nearly one out of every four families in the city of Los Angeles received an average credit of $1,700. In addition, 14 states, the District of Columbia, and two local jurisdictions offer earned income credits through their own tax codes that build off the federal EITC and further help to make work pay for low-income families. This paper documents that proliferating tax preparation services and products in low-income neighborhoods are diverting significant EITC dollars away from working families.

Like other taxpayers, many families who earn the EITC seek help in preparing their tax returns. After all, the process of filing for the EITC, as well as the newly-enacted refundable child credit, can be quite daunting, especially for low-income families whose first language is not English.[3] In fact, recent survey research confirms that low-income Hispanic parents, in particular, are less likely to know about the EITC; they may thus be more likely than other families to rely on tax preparation services to help them claim the credit.[4] Nor are they alone. Rather than contend with the system on their own, more than half of Americans today—and 68 percent of filers who receive the EITC—hire a tax preparation service to navigate the intricacies of the tax code and prepare their returns.[5]

These services, meanwhile, are carving out a profitable niche—albeit one that exacts a steep price in low-income communities—as they help low-income, often urban, working families obtain their often-large EITC refunds. Many tax preparation services offer not only assistance in preparing and filing returns, but also refund anticipation loans (RALs), refund transfers, and other products intended to help taxpayers obtain cash quickly. For these services, though, filers pay dearly in the form of numerous preparation fees, "filing fees" and other costs. And as this survey shows, these costs are large enough to consume a significant portion of the EITC dollars that flow into a community.

In this study, we first present findings from an informal survey in the Washington, D.C. area on the typical costs of tax preparation services and products for low-income filers. Second, we show how the "rapid refunds" that are sold primarily to lower-income taxpayers have contributed to growth in the commercial tax prep industry over the last several years. Third, we demonstrate that tax preparation services are concentrated in low-income urban and suburban neighborhoods where large shares of filers earn the EITC, especially in the U.S. South and West. Finally, we use new data from the Internal Revenue Service (IRS) to estimate the aggregate dollar amount diverted from low-income taxpayers for tax preparation services and associated products.

Our research finds that high-cost tax preparation services and products can significantly diminish the economic benefits of the EITC—both for low-income working families and for the neighborhoods in which they live. Federal, state and local officials should therefore take steps to ensure that tax preparation and expensive refund loans do not erode government's efforts to support work through the EITC. The federal government should reduce filing complexity for lower-income families by simplifying the rules behind the EITC and the new partially refundable child credit. All levels of government can expand the availability of free or very low-cost tax assistance through the IRS Volunteer Income Tax Assistance (VITA) program or through other local programs. The IRS should also stem the demand for high-priced loan products by making free or low-cost electronic filing widely available to low-income taxpayers through web-based technology. The federal government, with support from local leaders, can help connect low-income, "unbanked" filers to low-cost accounts into which their refunds can be directly deposited, eliminating the need and the temptation to rely on high-priced refund loan products. Finally, government should promote consumer awareness about the high price of "rapid refunds" and the alternative options available to low-income working families for receiving their EITC dollars.

II. Methodology

This survey analyzes information on the commercial tax preparation industry and the spatial distribution of its firms and clients in the nation's 100 largest metropolitan areas. These metropolitan areas, and their central cities, were the focus of an earlier Brookings Urban Center report, "A Local Ladder for the Working Poor." Using IRS data, that report detailed the spatial distribution of the EITC in those 100 metro areas. This study focuses attention on the relationship between EITC earnings and the location of tax preparation services that offer electronic filing of returns ("electronic returns originators," or EROs). The report also details, for the first time, the concentration of "rapid refund" loans in low-income communities throughout the 100 largest metropolitan areas, and provides an estimate of the total amount spent on tax preparation and loans by EITC recipients nationwide.

A few words are in order about the sources and types of information considered here:

Electronic Return Originators (EROs)

EROs, versus smaller paper-only preparers, receive the bulk of the scrutiny in this survey for several reasons. The

Glossary of Terms

ERO—Electronic return originator, alternately referred to in this report as "tax preparer" or "tax preparation service." An entity authorized by the IRS to originate the electronic transmission of federal income tax returns.

RAL—Refund anticipation loan, alternately referred to in this report as "rapid refund" or "refund loan." Money borrowed by a taxpayer from a lender based on the taxpayer's anticipated income tax refund.

e-file—Electronic filing. The submission of a tax return to the IRS via electronic, rather than paper, means. Taxpayers can e-file through an electronic return originator (ERO), personal computer software, or over the telephone through the IRS TeleFile program. E-filing speeds IRS processing, reducing turnaround time for refunds and the detection of errors on returns.

VITA—Volunteer Income Tax Assistance. A program involving IRS-trained volunteers who provide free tax assistance at community locations to individuals—often those with low incomes or limited English proficiency—who need assistance with basic income tax return preparation.

IRS maintains a national database of ERO name and address information because these firms are required to register with the service in order to submit electronic returns. We found that this database provides a more systematic source of information on tax preparers than is available through phone book searches and a more complete source than is available through Census surveys and private-sector sources.

Lower-income taxpayers who are eligible for the EITC are also more likely than higher-income individuals to use EROs to prepare their taxes. The demand for refund dollars is high among earners eligible for the EITC; while a considerable share save at least a portion of their refunds for some longer-term use, most use refunds right away to pay down credit card bills and to meet immediate needs such as rent and utilities.[6] By filing electronically, low-income filers are also able to receive their refund dollars more quickly. Finally, EROs are the largest vendors of the "rapid refund" products that receive scrutiny in this study.

Industry Background Sources

To describe the structure and size of the commercial tax preparation industry, we rely primarily on data culled from the annual reports of the two largest firms in the industry, H&R Block, Inc. and Jackson Hewitt Inc., as well as annual reports of the financial institutions with whom these companies partner to deliver products and services. These sources offer an in-depth look at only a portion of the full tax preparation industry, since the big chains encompass only about one in six EROs in the 100 largest metropolitan areas. However, these two firms account for nearly a third of all commercially prepared federal individual income tax returns, and nearly half of all returns that are filed electronically. Altogether, just over 30 percent of all year 2001 individual income tax returns were e-filed. Similarly, of the 65 million individual income tax returns prepared by tax professionals in 1999, 32 percent (21 million) were e-filed.[7]

Price Information

In addition to describing the size of the industry and its growth over time, annual reports from H&R Block and Jackson Hewitt also reveal information on revenues for several of these chains' most popular products and services. To gather information on the prices that these chains charge, as well as the cost of products and services offered by independent agents, we telephoned 124 tax preparation services listed in the Washington, D.C. metropolitan area phonebook between September 2001 (when many offices were closed) and March 2002. Of the services contacted, 60 responded to our requests for price information. Local franchises of national chains, as well as independent agents, were surveyed in order to gauge the degree to which local prices may vary from the national averages indicated in annual reports.

EROs, Rapid Refunds and the EITC

To describe the spatial distribution of tax preparation services in cities, we rely primarily on the aforementioned IRS database containing name and address information for commercial originators of electronic returns—the EROs. We use these data, in combination with a separate IRS database containing 1998 zip-code level information on EITC receipt, to compare the location of EROs to the location of EITC earners and those who file their returns electronically.[8] A third IRS database provided to Brookings reports zip code-level information on the number of 1999 returns claiming the EITC that have an associated RAL, and the amount of EITC dollars claimed on those returns. We use price information from our survey of Washington, D.C. area tax preparers to generate a rough estimate of the savings that could accrue to low-income families if they prepared and filed their returns at no cost.

III. Background

How Large Is the Industry?

The tax preparation services industry is highly fragmented, although one name currently dominates the business: H&R Block. According to its publicly filed annual report for the fiscal year ended April 30, 2001, H&R Block prepared 16,442,000 individual income tax returns for the 2001 tax year, or about 13.9 percent of all individual returns filed with the IRS. Its largest competitor is Jackson Hewitt, which prepared more than 2.2 million tax returns in 2001, or about 1.7 percent of all returns filed.

The vast majority of paid tax preparation services, at the same time, is provided by a disparate array of unaffiliated professionals, including certified public accountants, attorneys and enrolled agents, as well as fly-by-night amateurs. Using IRS figures, the National Association of Tax Professionals (NATP) estimates that there are approximately 300,000 practicing tax professionals in the U.S.[10] Numerous software companies also sell tax preparation software or offer preparation and filing services online.

Meanwhile, there are no general national educational or professional standards that tax preparers must satisfy before they can take on clients, although enrolled agents must be certified to practice by the IRS. Consequently, the tax preparation industry remains virtually unregulated. Ultimately, quality control is maintained mostly by the paid tax preparer's signature on the return, which subjects the preparer to liability for any fraud or errors in the returns they prepare and obligates preparers to defend their clients before the IRS in the event of an audit.

Another peculiarity of this somewhat ad hoc industry is the part-time status of many tax preparers, who frequently follow the standard January through April filing season. Our informal survey of tax preparation services in the Washington, D.C. metropolitan area, for example, revealed a significant number of seasonally operated, one-person storefronts. Of 80 Yellow Page listings for tax preparation services in the city of Washington, D.C., only 25, or about 31 percent, were affiliated with a national chain. Moreover, there is a good deal of anecdotal evidence that during tax filing season, tax preparation services that operate off-the-books sprout up in low-income city neighborhoods nationwide.

Despite the industry's current fragmentation, there is some indication of consolidation and growth. While the number of offices owned or affiliated with H&R Block nationwide has held steady since the mid-1990s, the number of Jackson Hewitt franchises has expanded dramatically in recent years. The company has grown from only 22 locations 15 years ago to approximately 3,300 stores today.[11] Over the past four years alone, Jackson Hewitt has more than doubled its number of locations and returns filed.[12]

Revenues derived primarily from the collection of various return-preparation fees from filers indicate that the commercial tax preparation business in the U.S. is growing fast. In the fiscal year ended April 30, 2001, H&R Block earned revenues of nearly $1.7 billion from its tax preparation and related services, including RALs, an increase of 15.6 percent over the previous fiscal year.[13] Although current revenues for Jackson Hewitt are not publicly available because of its status as a subsidiary of Cendant Corporation, a recent company press release announced that Jackson Hewitt's revenues for 2001 topped earnings in 2000 by 36 percent.[14] In 1997, the last year for which figures are publicly available, Jackson Hewitt's revenues totaled $31.4 million.[15] With Jackson Hewitt now preparing more than twice the number of returns it did in 1997, and these two firms accounting for only a third of all returns filed, it is reasonable to extrapolate that tax preparation is a multi-billion dollar industry.

What Is a RAL?

Refund anticipation loans (RALs) are an important reason for the industry's recent growth, and a large revenue source for the commercial chains (see Finding B). RALs are similar to "payday loans" in that they provide advances on a borrower's anticipated income—in this case, a tax refund—and come at a steep price. In the case of the RAL, the loan is repaid when the IRS issues the borrower's expected refund. The principal attraction of RALs is that customers are usually able to receive cash proceeds from their loans within about two days of electronically filing their tax returns, or about seven to ten days sooner than if they had requested direct deposit of their refund to a personal bank account. Some services even offer an "instant" RAL, so that taxpayers can receive a check as they leave the preparer's office.[16] RALs also permit taxpayers without bank accounts (and who are consequently without direct deposit capabilities) to obtain their refunds without waiting for a paper check from the IRS. And because tax preparation and other fees are deducted from the proceeds of a RAL, taxpayers who do not have the funds to pay for services up-front may find RALs particularly attractive.

A handful of banks have entered into partnerships with tax preparation services to issue RALs. Often, these banks are nationally chartered and are thus not subject to laws that many states have adopted to regulate high-cost consumer loans.[17] There are two varieties of arrangements between banks and tax preparation services for the issuance of RALs. The first of these involves the payment of a flat referral fee by the bank to the tax preparer for each RAL application that is approved.[18] Under this arrangement, the bank receives all application and processing fees in exchange for assuming all of the risk that the actual refund will be insufficient to cover the loan. Under the second type of arrangement, the bank and tax preparation service share both the risks and the fees.[19] Because this arrangement can be more profitable to tax preparation services, it is also more common.

RALs are comparatively low-risk loans, which is part of their appeal to banks. Although default rates on RALs are somewhat higher than on other types of credit, banks have put a number of mechanisms into place to lower their risks (in addition to the "debt indicator" tool supplied by the IRS, described below). The most significant of these is a cooperative agreement under which RAL issuers share information about outstanding delinquencies owed by RAL applicants. Under this arrangement, if a taxpayer owing money from a prior RAL applies for another loan the following year from another bank, the second bank will deduct the funds owed to the first bank before sending the remaining proceeds to the borrower.[20]

In addition to RALs, tax preparation services typically offer a product that is variously called an "accelerated check request" or a "refund transfer," which is geared toward taxpayers who either don't qualify for a RAL or who lack a bank account. With these products, the IRS issues refunds by direct deposit to the tax preparation service, which then issues a check to the taxpayer in the amount of the refund, minus fees. Refund transfer programs involve no risk to the affiliated lender, since the tax preparation service already has the refund in hand when it makes out a check to the taxpayer. This service essentially enables taxpayers without bank accounts to enjoy the benefits of direct deposit, which is speedier than the paper checks issued by the IRS. These products also come at a sizable cost to the filer and serve, like RALs, to divert additional refund dollars away from low-income families.

IV. Findings

A. In the Washington, D.C. area, taxpayers claiming an Earned Income Tax Credit (EITC) of $1,500 spend, on average, more than 10 percent of this amount on tax preparation, electronic filing and a refund loan if they use a commercial tax preparer.

Information on the prices charged by national chains, as well as data from our informal survey of Washington-area commercial tax preparers, confirm that low-income taxpayers who choose to file through a preparer can expect to spend large sums to file simple forms. Receiving refund dollars via a RAL can double the price.

1. On average, services affiliated with national chains charge at least $100 in fees per customer for tax preparation and filing, plus an additional $75 to $100 for a RAL.

Because of the fragmentation of the industry, fees and services among tax preparation services (even among those franchises affiliated with a national chain) vary quite widely. The fee structure for loans on refunds, nevertheless, appears relatively standard. Borrowers generally pay an application fee and/or document processing fee, plus a finance charge that is based on a percentage of the amount borrowed.

For fiscal year 2001, H&R Block reported that its average total fee per client was $118, an 11 percent increase over the prior year.[21] Documentation from a return prepared by a suburban Washington H&R Block in January 2001 reveals that refund loans, or RALs, can add significantly to this price.[22] The preparation fees for a federal return (including the EITC) and a District of Columbia return totaled $95. A RAL for the anticipated refund of $2,500 cost the taxpayer an additional finance charge of $121—$43 to H&R Block for its per-RAL license and documentation preparation fees, plus $78 to Household Bank.[23] Given that this taxpayer probably saved only about a week's wait on her refund, the annualized interest rate on her RAL was roughly 250 percent.[24] Fees for H&R Block RALs appear to have increased again in 2002. A recent report discloses that a $2,500 refund loan in 2002 will generate a $90 fee to Household Bank (presumably in addition to the license and documentation preparation fees levied by H&R Block).[25]

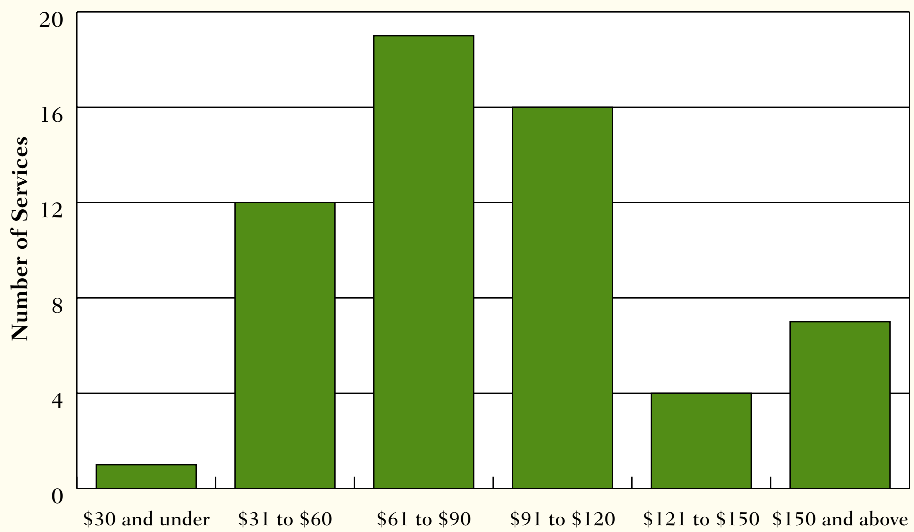
No recent information is available on the average prices charged nationally by Jackson Hewitt for preparing and filing returns, though their per-client fee has undoubtedly increased from its $99 average in 1997.[26] Jackson Hewitt's fee structure for RALs, however, appears to have remained relatively constant since 1997. In 1997, Jackson Hewitt customers applying for RALs each paid a $24 application fee, a $25 document processing fee, and an additional RAL finance charge equal to approximately four percent of the amount of the loan. At this price, a taxpayer anticipating the same $2,500 refund would pay $149 in RAL fees alone.

2. In the Washington, D.C. area, the average EITC filer can expect to spend $100 on tax preparation and filing, not including additional fees for the purchase of a RAL.

Gauging the average cost of tax preparation services in a major metropolitan area proved to be quite challenging. An informal telephone survey of 124 tax preparation services in the Washington, D.C. metropolitan area yielded 60 responses, a number of them incomplete. In each case, we asked for an estimate of the minimum cost of preparing a federal Form 1040A (a somewhat simplified form which most EITC claimants are eligible to use), including schedule EIC (required to claim the EITC), as well as an accompanying state return. We also asked about additional fees for electronic filing, and whether or not the service offers RALs or similar financial products (and if so, the price).

A number of the services contacted refused to give quotes over the telephone or were evasive in their responses. Several services would not provide even a minimum estimate of costs and instead insisted that fees would depend on the complexity of the return and the type of services involved. Many services providing estimates gave them under the caveat that actual fees might run much higher, depending on the return. Some services also provided estimates for certain services but not others. Because a part of this survey occurred over the fall of 2001, many offices were also closed when first contacted. We did, however, contact these offices again after January 1, 2002 with greater success. Summarized below are the results of our survey regarding the array of costs associated with tax preparation:

Figure 1. Fees for Preparing and Electronically Filing Federal* and State Returns, Washington, D.C. Area, 2002



** Including the EITC*

Source: PPI Survey, March 2002

Fees for preparing federal Form 1040A and equivalent state form, plus claim for EITC

We asked each responding service to estimate the minimum cost of preparing federal and state tax returns for a taxpayer claiming the EITC. Many responded with a range of prices, depending on the complexity or the refund amount involved.

Prices varied significantly. The lowest estimate, provided by one service, was $25. However, most services (38 of 60) quoted fees between $75 and $100. Only 12 services responded that a taxpayer could expect full service for less than $50. Five services named minimum prices of between $100 and $150, and five others quoted fees in excess of $150. Services that were part of national chains generally quoted fees of between $75 and $100. Overall, the price quoted for preparing an EITC filer's returns averaged between $85 and $91.[27]

Fourteen of the 60 responding services (23 percent) charged an extra fee (in addition to the quoted minimums discussed above) for preparation of the schedules accompanying a claim for an EITC. Of these services (which included stores affiliated with national chains), four quoted prices of less than $15 and seven quoted charges between $15 and $35. One service responded that it charged $65 for preparation of an EITC schedule, and two others declined to give a specific price. The average fee (using the low end of any ranges given) was a little under $20.

Fees for electronic filing

Of the 60 services that responded to our questions, 42 provided e-filing and 30 of those services reported charging an additional fee to file a return electronically, over and above the fees for preparation of returns. Of the services providing a specific price, the average (using the low end of any ranges given) was $29.[28] Many stores (including the Jackson Hewitt franchises) responded that e-filing is included in the tax preparation fee but that they will charge taxpayers an e-filing fee if they do not also have their returns prepared at their stores. One store (affiliated with a national chain) quoted a stand-alone e-filing fee of $100.

Fees for RALs and refund transfers

Although all of the services affiliated with a national chain offered refund loans and similar products, less than a third of the non-affiliated services in our survey did. Of the 42 unaffiliated respondents in our survey, only 13 offered RALs. Of the 31 total services in our survey that offered RALs, fewer than two-thirds would provide us with an estimate of the cost of a RAL. Of the respondents, ten declined to give a specific estimate, saying that fees would depend on what the partnering bank would charge. Ten services (including many of the Jackson Hewitt outlets surveyed) reported that RAL fees would equal a certain fixed amount, ranging from $10 to $85,

Table 1. Average Fees for Tax Preparation, Electronic Filing and $1,500 Refund Loan in the Washington, D.C. Area

Basic preparation fees (one state and federal return)	$84.96
Schedule EIC preparation fee*	4.69
Electronic filing fee*	12.00
Total—preparation and filing	$101.65
RAL fees**	$88.00
Preparation fees plus RAL fees	**$189.65**
Total fees as percentage of $1,500 refund	**12.64%**

** Weighted average, including zero responses.*

*** Based on fee structure for H&R Block RAL obtained in 2001: $43 license and documentation fee, plus bank fees amounting to roughly 3% of refund amount.*

Source: PPI survey, March 2002

plus the loan fees charged by the bank. Eight services provided us with widely varying ranges of potential costs, with one service claiming that a RAL could cost a taxpayer as much as $1,000. Other services provided cost ranges of $40 to $90, $70 to $150 and $30 to $300, although one service claimed that a RAL would only cost $10 to $20, and another service claimed it did not charge an extra fee. Three services gave estimates of around $90.

Total costs

We summed, for each responding service, the total estimated costs provided by that service for tax preparation and e-filing (including additional charges for EITC filers). We did not include RAL fees, given the variance in cost estimates. Again, where the responding service provided a range of costs, we used the low end of the range in arriving at a total. Excluding the response of the service that quoted a price of $700, the average total cost of tax preparation fees in our study is $101.65. (The number of responses in different price ranges are shown in Figure 1.)

The purchase of a RAL can easily double this amount. If, for example, a taxpayer paying the average amount of $100 for tax preparation services also purchased a RAL for $90 (the most frequently cited response in our survey), total costs would equal $190, or 12.6 percent of the average federal EITC refund in the Washington, D.C. area (see Table 1).[29] This outlay may, in fact, be typical of customers at national chains who opt for RALs. One service in our study, a member of a national chain, cited the following prices: $60 for preparation of a federal tax return, $34 for a state return, $20 for e-filing and up to $90 for a RAL, for a total of $204.

Fees for cashing checks

According to the Federal Reserve, 22 percent of families with less than $25,000 in income (the majority of the EITC-eligible population) lack a bank account of any kind.[30] Many low-income taxpayers may thus need to avail themselves of a check-cashing service in order to cash the RAL or refund transfer check provided by the preparation service. As a result, many families pay an even higher price to obtain the EITC. The largest national check cashing chain, ACE Cash Express, is partnering with H&R Block to install automated check-cashing machines in the firm's offices. Anecdotal surveys indicate that ACE actually charges a premium to cash tax refund checks, even though the risk associated with such checks is minimal.[31] Even paying the national average 2 percent fee to cash such a check would add an additional $30 to the cost of obtaining a $1,500 refund.[32]

B. The nation's largest commercial tax preparation service and "rapid refund" lenders earned $357 million from "fast cash" products in fiscal year 2001.

At a price of $90, one might think that commercial tax preparers would have difficulty selling short-term loans to low-income customers. Industry data, however, show that the purchase of these "fast cash" products is common, and spreading.

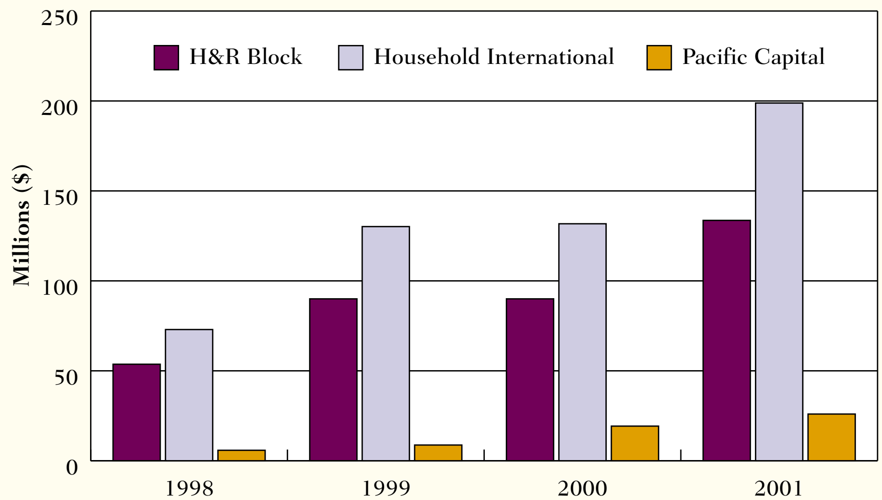
IRS initiatives have precipitated a rapid growth in the demand for refund loans. E-filing and direct deposit have greatly reduced taxpayers' wait for their refund checks—from six weeks to 14 days. At the same time, they have reduced lenders' risks in issuing loans secured by a taxpayer's refund: direct deposit enables lenders to receive RAL repayments directly from the IRS, and the two-week average term of RALs is relatively short. In addition, the IRS now notifies lenders if a RAL applicant owes any outstanding federal debts (e.g., back taxes, child support, student loans, etc.) which his/her tax refund might be used to offset. This so-called "debt indicator" has become an important underwriting tool for RAL issuers.

Fees from refund loans and other "fast cash" products have consequently come to make up a significant portion of the revenues generated by national tax preparation companies. For the fiscal year ended April 30, 2001, H&R Block earned approximately $134 million in RAL fees, an increase of nearly $44 million over the prior year. The company attributed this growth to higher average fees per RAL, which increased 44 percent over the preceding year, and a surge in the number of RALs issued. In 2001, the company processed nearly 4.5 million RALs, compared to 2.8 million only two years earlier. Altogether, a "fast cash" product accompanied approximately 48 percent of the 13.3 million returns filed electronically by the company in fiscal 2001.

In fiscal 1997, the last year for which financial information is available, income from RALs and accelerated refund products comprised 29.8 percent of Jackson Hewitt's total revenues.[34] That year, the firm issued 472,000 RALs and related products for fees of $9.4 million, an increase of more than one third over the previous year. According to the company, its customers "consist primarily of low to middle income taxpayers who typically are entitled to tax refunds and want to receive their refund checks as quickly as possible."[35] Its annual report for 1997 noted that, "approximately 80% of Jackson Hewitt's customers had annual gross wages under $30,000 and over 62% had annual gross wages under $19,000. Many customers also qualify for an increased refund as a result of the Earned Income Credit…."

The popularity of refund loans has, in fact, been a major factor in the phenomenal growth that Jackson Hewitt has enjoyed in recent years, principally in low-income markets. On its website, the company bills itself as a "leader in electronic filing and refund anticipation loans," and according to the company's public filings, more than half of its customers purchase RALs or similar products. During the 1997 tax season, for example, the company reported that about 54 percent of its customers bought RALs or similar products. Assuming that a similar percentage of its filers in tax year 2001 purchased RALs, Jackson Hewitt processed approximately 1.2 million RALs last year.

Figure 2. The Growth of Refund Loans: H&R Block, Household International, and Pacific Capital Bancorp, 1998–2001



Source: SEC Form 10-Ks

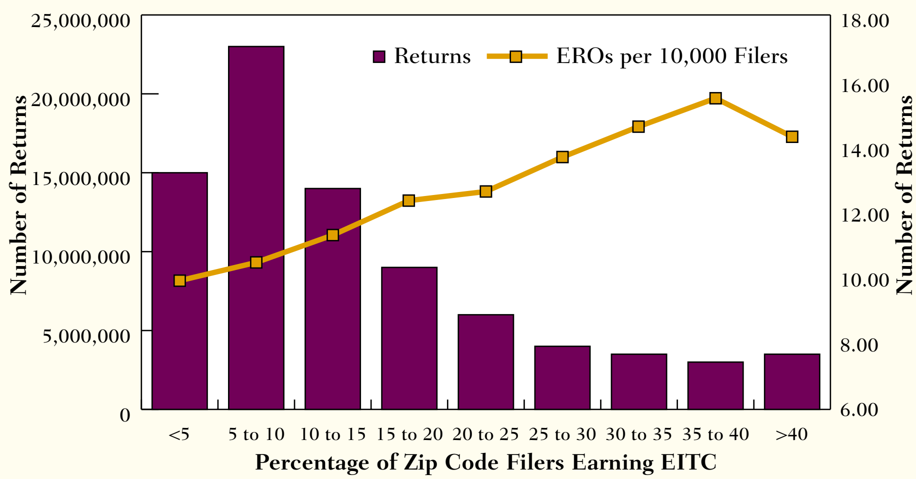
Two financial institutions dominate the lender side of the RAL/refund transfer industry: Pacific Capital Bancorp, and Household International Inc., which is also one of the nation's largest lenders of subprime home equity loans.[36] Household, which provides all of the RALs for H&R Block, more than doubled its RAL income from $73 million in 1998 to $198 million in 2001.[37] In 2001, the company originated about 6.4 million RALs, with a loan volume of about $8.4 billion. The majority of these customers, Household reported, "are renters with household incomes of less than $25,000 who are entitled to refunds of greater than $2000."[38]

Pacific Capital, which underwrites Jackson Hewitt's RALs, nearly quadrupled its RAL income over the past three years, earning $25.2 million in 2001, compared to $6.8 million in 1998.[39] Pacific Capital has also seen significant increases in its income from refund transfer services; revenues from this product rose from $4.8 million in 1998 to $7.3 million in 2000. In its most recent annual report, Pacific Capital confidently predicted that its RAL and refund transfer programs "will continue to increase in volume because the IRS wants to encourage more taxpayers to file electronically." Altogether, H&R Block, Pacific Capital and Household earned $357 million in fiscal 2001 from the sale of RALs and refund transfer services, more than double the $138 million earned by these companies in fiscal 1998 (Figure 2).

C. Electronic tax filing and preparation services cluster in neighborhoods where large numbers of families claim the EITC.

Research on the spatial distribution of the EITC has found that the credit boosts incomes and purchasing power by significant amounts at the neighborhood, city and metropolitan levels.

Figure 3. Tax Preparer Penetration, and Number of Returns in 100 Largest Metropolitan Areas, by Share of Zip Code Filers Earning EITC



Source: 1998 IRS Zip Code Files; IRS e-file Provider Database

For instance, in 1998, the $430 million in EITC refunds flowing into the city of Chicago boosted purchasing power by an average of $2 million per square mile. That same year, there were zip codes in New York, Fort Lauderdale, El Paso and a number of other cities where families collectively earned over $20 million from the EITC.

While serving as an economic boon to low-income communities, tax refund dollars also represent a business opportunity for professional tax preparers. In fact, our analysis of the spatial distribution of tax preparers, as represented by electronic return originators (EROs), indicates that the concentration of EITC refund dollars in low-income communities leads tax preparation services to locate there more frequently than in other, higher-income neighborhoods.

1. High-EITC zip codes are home to 50 percent more EROs per filer than low-EITC zip codes. Jackson Hewitt stores are even more highly concentrated in high-EITC zip codes.

We first investigate, for zip codes in the 100 largest metropolitan areas, the relationship between the penetration of commercial tax preparers, or EROs, and the share of filers earning the EITC. We divide the number of EROs in a zip code by the number of filers in that zip code to control for the fact that tax preparation firms, like most retail businesses, will choose to locate near a greater number of potential customers.[40]

There is a clear relationship between the location of EITC earners and the location of tax preparation services. In zip codes where less than a tenth of all filers earn the credit, there are roughly ten EROs for every 10,000 filers. As Figure 3 shows, this figure increases by about one ERO per 10,000 filers with each additional 5 percent of the filing population claiming the EITC. The ERO penetration rate reaches 15.6 per 10,000 filers in zip codes where between 35 and 40 percent of all filers receive the credit. These zip codes alone generated 2.2 million returns in 1999.

It may be that tax preparation firms locate in higher-EITC zip codes because population in general is higher there, enabling them to benefit from economies of scale even in the face of greater competition. However, the data confirm that the relationship between EITC receipt and tax preparer penetration is largely independent of zip code population. Across zip codes of different population levels, the average number of EROs per 10,000 filers does not deviate much from the 100-metro average of 11.5. Thus, these firms are clearly over-represented in communities with large concentrations of EITC earners, regardless of population levels.

Jackson Hewitt storefronts, in particular, are disproportionately located in high-EITC zip codes. Table 2 shows the share of all returns, all EROs, and all H&R Block and Jackson Hewitt stores located in zip codes of varying EITC receipt in the top 100 metro areas. As the previous charts revealed, EROs in general are over-represented, based on return volume, in higher-EITC zip codes. The share of all H&R Block stores located in zip codes with above-average EITC receipt (20 percent and up) is similar to the share of all returns in those zip codes. Jackson Hewitt stores, on the other hand, are highly over-represented in these neighborhoods—even more so than EROs generally. Whereas 23 percent of all returns originate in zip codes where more than 20 percent of filers earn the EITC, 38 percent of Jackson Hewitt stores are in these zip codes.

As noted previously, the faster refund turnaround available through electronic filing—and the accompanying access to refund anticipation loans—appeal to many low-income filers expecting substantial refunds. The concentration of EROs in neighborhoods with large numbers of EITC earners leads to high e-filing rates

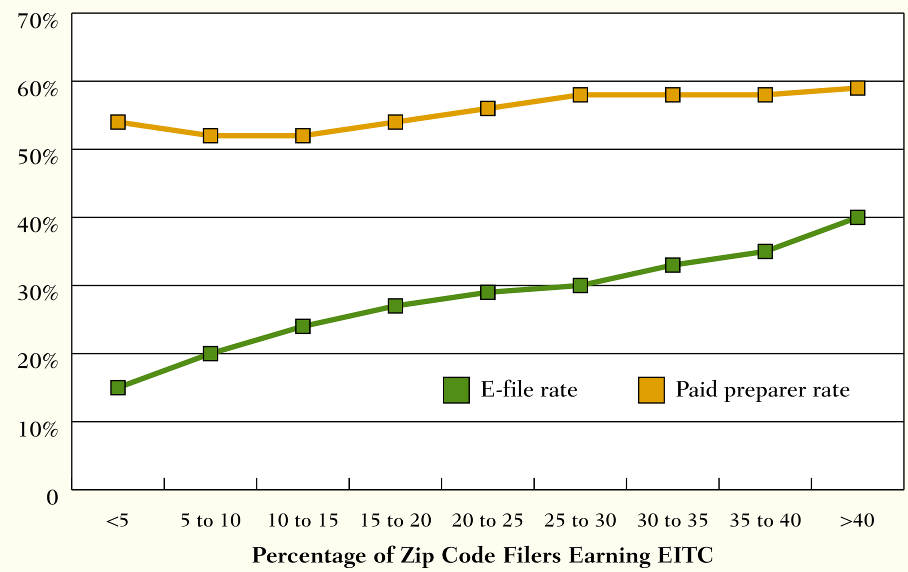
	< 10%	10%-20%	20%-30%	30%-40%	> 40%
All Returns	48.2%	29.0%	12.4%	6.8%	3.6%
All EROs	43.0	29.6	14.1	8.8	4.5
H&R Block	43.1	33.8	12.9	7.1	3.1
Jackson Hewitt	25.5	35.8	19.0	12.7	7.0

Table 2. Percentage of Total Returns, Tax Preparers, and National Chain Tax Preparers in Top 100 Metropolitan Areas, by Share of Zip Code Filers Earning EITC

Source: 1998 IRS zip code files; IRS e-file provider database

among the lower-income population. For every 5 percentage point increase in the share of a zip code's filers that earn the EITC, the share of taxpayers filing their returns electronically increases 3 percentage points (Figure 4). This is consistent with a recent IRS finding that 52 percent of all EITC recipients file returns electronically (versus 32 percent of all filers).[41] The average share of a zip code's taxpayers using a paid preparer, in contrast, does not change much as the share earning the EITC increases. Unlike higher-income families, who are likely to have access to software that allows them to file their own return electronically, the large majority of families that e-file for the EITC probably do so through a paid tax preparer.[42]

Figure 4. Share of Zip Code Taxpayers Filing Electronically in 100 Largest Metropolitan Areas, by Share of Zip Code Filers Earning EITC



Source: 1998 IRS Zip Code Files; IRS e-file Provider Database

2. Cities and suburbs in the U.S. South and West were home to low-income neighborhoods with the highest concentrations of tax preparers.

Across the 100 metropolitan areas, there is a consistent relationship between the share of the filing population that earns the EITC, the share that files electronically, and the number of EROs per filer. Underlying this relationship are some strong regional patterns. In general, cities and suburbs in the U.S. South and West exhibit a higher concentration of EROs in neighborhoods where large shares of the population earn the EITC.

The concentration of tax prep firms in high-EITC neighborhoods is not a central-city phenomenon alone. Figure 5 shows that ERO penetration increases with increasing share of EITC filers, regardless of whether the zip code is located in the central city. While there are more EROs per filer in low-EITC central city zip codes, once the share of filers earning the EITC exceeds 20 percent, average ERO penetration rates are almost identical in cities and suburbs.[43] Tax preparers appear to cluster wherever EITC recipients do.

While city-suburb differences in ERO penetration were not pronounced, at all levels of EITC receipt, zip codes in the South and West have more EROs per filer. Table 3 shows that at the low end of the EITC range, the regional disparities are not large; an average of between 9.1 (Northeast) and 11.5 (West) EROs per 10,000 filers are located in zip codes where less than 10 percent of filers earn the credit. As the share of filers receiving the EITC increases, however, the difference between regions grows. The ERO penetration rate climbs highest

Table 3. Tax Preparer Penetration in 100 Largest Metropolitan Areas, by Share of Filers Earning EITC and Region

EROs per 10,000 filers

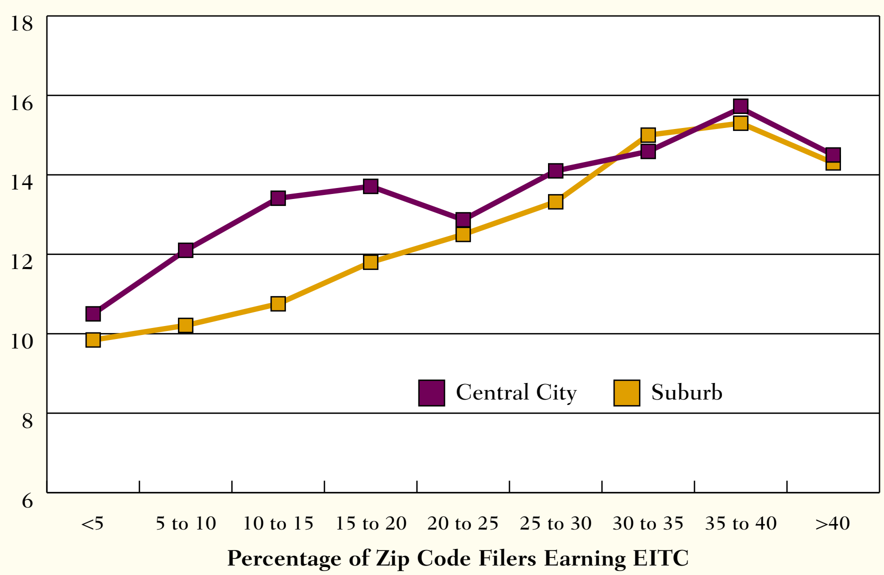
Share Earning EITC	Northeast	Midwest	South	West	Total
< 10%	9.1	10.0	10.6	11.5	10.3
10% to 20%	8.7	10.9	12.8	12.8	11.7
20% to 30%	9.9	10.4	15.1	13.2	13.1
30% to 40%	12.3	10.4	18.3	14.8	15.0
> 40%	12.3	10.7	16.4	13.8	14.4

Source: 1998 IRS Zip code files; IRS e-file Provider database

in areas of the South where between 30 and 40 percent of all filers earn the credit, and there are more than 18 EROs per filer on average. In San Antonio, for instance, the nine zip codes in that range of EITC receipt have an average of 20 EROs for every 10,000 filers.

In contrast, tax preparers in the Midwest generally do not appear to concentrate in city and suburban neighborhoods with high rates of EITC receipt. At the same time, though, Midwestern zip codes have the highest e-filing rates at every level of EITC receipt, anywhere from 3 to 10 percentage points above the national average. These seemingly contradictory findings may be attributable to the larger presence of the two large national chains, H&R Block and Jackson Hewitt, in the Midwest than in other regions. Nearly 27 percent of EROs in the Midwest are members of one of the two chains, versus 14 percent in the other regions. With chains handling a larger volume of returns than their independent competitors, high-EITC zip codes in the Midwest may experience the same effective level of tax prep supply as in other regions, even though they are home to a lower number of EROs per filer.

Figure 5. Tax Preparer Penetration by Zip Code EITC Receipt: Cities and Suburbs in 100 Largest Metropolitan Areas



Source: 1998 IRS Zip Code Files; IRS e-file Provider Database

D. An estimated $1.75 billion in EITC refunds in 1999 was diverted toward paying for tax preparation, electronic filing and high-cost refund loans.

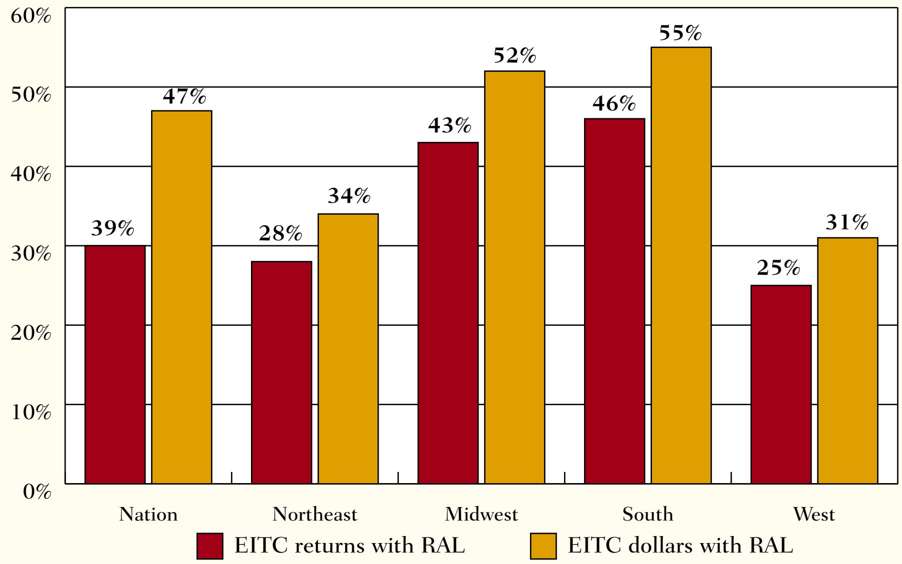
The evidence presented thus far suggests that commercial tax preparers are marketing their services and products most heavily in low-income communities. New data from the IRS, explored in this section, point to the "success" of this strategy. The amount of EITC dollars diverted away from low-income families, to these firms and their affiliated lenders, is substantial.

Nationwide, 39 percent of taxpayers who earned the EITC in 1999 received their tax refunds via refund loans (Figure 6). By contrast, only 4 percent of taxpayers who did not receive the EITC in 1999 purchased a RAL. More importantly, almost half of all EITC dollars were distributed via a refund loan, indicating that taxpayers who received larger refunds as a result of claiming the EITC were more likely to purchase a RAL.

Because prices for most RALs are based on the amount of the anticipated refund, these families paid more for their loans on average than other EITC recipients would have paid. In 1999, the average EITC nationwide was $1,655, but the average EITC claimed through a RAL was $2,003. Applying our price findings from the Washington region—that a refund loan for $2,000 costs about $100 on average—suggests that the 7.5 million EITC recipients who purchased refund loans in 1999 spent perhaps $750 million on those products.

Assuming further that, as the national statistics indicate, 52 percent of all EITC recipients filed their returns electronically, and that they spent an average of $100 to do so, roughly $1.75 billion in EITC refunds in 1999 was diverted to pay for tax preparation, filing and rapid refunds.[44] While price figures from our informal Washington, D.C. area survey may not be perfectly representative of the nation as a whole, given the similarity of local averages to the prices reported by national chains, we think they serve as reasonable estimates.

Figure 6. EITC Returns, and EITC Dollars, with Associated Refund Loan in 100 Largest Metropolitan Areas, by Region, 1999



Source: 1999 IRS ETA IMF Marketing Database

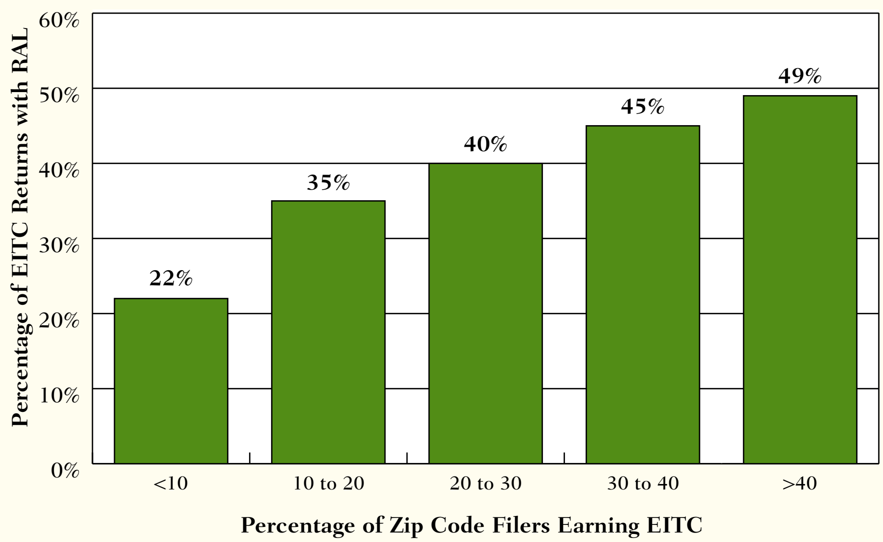
Providers of rapid refunds appear to have made their greatest inroads in neighborhoods where large shares of taxpayers earn the EITC. As shown in Figure 7, in zip codes where less than 10 percent of families claimed the credit, 22 percent of EITC earners purchased a RAL. In zip codes where between 30 and 40 percent of families received the EITC, more than double that share (45 percent) got rapid refunds. The share was even higher in neighborhoods where at least 40 percent of taxpayers earn the credit.

Several factors may contribute to this pattern. First, the concentration of EROs marketing their services in higher-EITC neighborhoods may stimulate greater demand for rapid refund products. After all, many tax preparation services market their products aggressively—for example, by blanketing neighborhoods with flyers promising special rates or discounts. Second, low-income taxpayers in high-EITC neighborhoods receive higher EITCs on average than taxpayers in low-EITC neighborhoods.[45] As a result, they may desire quick (if expensive) refunds, either because the amount is greater or because they need the cash to cover immediate expenses.[46] Third, social networks in high-EITC neighborhoods may serve to encourage low-income families to claim their refunds via RALs. When most of a taxpayer's friends and neighbors file their returns at a local tax preparation service, and pay to receive their refunds within two or three days, he or she may be persuaded to do the same thing. Whatever the relative roles of these factors, the neighborhoods where low-income working families are most concentrated are clearly those that spend the largest sums of EITC dollars on tax preparation services and products.

The nationwide statistics, moreover, tend to mask considerable diversity across metropolitan regions, cities and neighborhoods in the usage of high-priced tax services. As the ERO location information suggested, the percentage of EITC earners who purchase rapid refunds is highest in metropolitan areas in the South (Figure 6). A map of Washington, D.C. shows wide swaths of the city in which half or more of all EITC returns include a refund loan (Figure 8). Many of these neighborhoods are inundated with tax preparation services.

Rapid refund rates are also quite high in the Midwest, perhaps reflecting the prevalence of high-volume chain outlets in that region. Somewhat smaller, though still considerable, shares of EITC earners in the Northeast and West receive their refunds through a RAL. (Appendix A lists the

Figure 7. Percentage of EITC Returns with Refund Loan in 100 Largest Metropolitan Areas, by Share of Zip Code Filers Earning EITC, 1999



Source: 1999 IRS ETA IMF Marketing Database

share of families earning the EITC, and the percentage of EITC returns and EITC dollars associated with a RAL, for each of the 100 largest metro areas, their central cities and suburbs.)

These regional patterns are evident in a list of the cities in which the highest shares of EITC recipients received RALs (Table 4A). Eight of the top ten cities on this measure are located in the South. In most of these cities, a very high percentage of taxpayers receive the EITC (Birmingham, AL was second in the nation in 1999), and the average EITC refunded through a RAL is much larger than the national average of $1,655. Two Midwestern cities—Gary, IN and Cincinnati, OH—also show up in the top ten. In all of these cities, at least six out of every ten EITC earners purchased a rapid refund.

In several cities, RALs divert millions of federal dollars each year away from low-income families to a handful of national banks. The list of cities in which the largest number of EITC recipients receive refund loans includes, not surprisingly, some of the nation's largest (Table 4B). The order in which they appear, though, is notable. Although there were 120,000 more EITC earners in Los Angeles/Long Beach than in Chicago in 1999, there were 43,000 more EITC recipients with RALs in Chicago that year. The tenth largest city in the U.S., Detroit, appears seventh on the list because of the large share of its taxpayers who earn the EITC (33 percent) as well as the large share of those families who receive rapid refunds (57 percent). And Memphis appears on both lists, thanks to the extraordinarily high percentage of its low-income working families who receive the EITC via a RAL.

Regional differences aside, there were cities, suburbs and neighborhoods in every region of the U.S. in which more than half of all low-income working families received their refund dollars via a RAL. Thirty-three central cities in the top 100 metropolitan areas saw a majority of their EITC earners purchase RALs in 1999. Included were Northeastern cities such as Harrisburg, PA and Rochester, NY; Texas cities such as Dallas and Fort Worth-Arlington; and four of Ohio's largest cities. The same was true in the suburbs of 12 metropolitan areas—including eight in Virginia, North Carolina and South Carolina. More than 400 zip codes nationally, collectively home to more than half a million low-income working families, saw more than three-quarters of EITC dollars claimed through an expensive rapid refund.[47]

V. Policy Implications

The EITC serves as the nation's largest and most effective program for assisting working poor families. Many households, however, rely on costly tax preparation services to claim their credits, thereby diminishing their net benefits from the program by considerable amounts. As a result, loans with triple-digit interest rates are now attached to nearly half of all EITC refund dollars. Overall, roughly $1.75 billion intended to benefit low-income families flows instead to commercial tax preparers and affiliated national banks.

To be sure, the concentration of tax preparation services in low-income communities points to a considerable demand for assistance in preparing returns, and in gaining access to EITC refunds quickly. Clearly, commercial tax preparers provide a service of some value to the many EITC recipients who do not understand how to file for the credit, or who want the comfort of having a "professional" fill out their forms.[48] The fact that EITC claimants are about eight times as likely to be audited by the IRS as higher-income taxpayers may further encourage working poor families to seek the assistance of paid preparers.[49] Additionally, the

Table 4A. Top Ten Central Cities by Percentage of EITC Earners with Refund Loans, 1999

	Central City	Percentage of Taxpayers Earning EITC	Percentage of EITC Earners with RAL	Percentage of EITC Dollars with RAL	Average EITC Associated with RAL
1	Greenville, SC	27.9%	69.9%	80.1%	$1,804
2	Memphis, TN	31.5	66.2	73.6	2,069
3	Birmingham, AL	36.3	63.9	71.5	2,112
4	Little Rock, AR	19.4	63.3	73.3	2,094
5	Greensboro-Winston-Salem, NC	16.8	63.2	73.0	1,900
6	Atlanta, GA	24.7	62.8	71.8	2,068
7	Gary, IN	34.1	62.7	69.5	2,020
8	Baton Rouge, LA	25.8	62.3	71.2	2,200
9	Mobile, AL	34.3	60.5	67.8	2,227
10	Cincinnati, OH	19.3	59.3	70.2	1,969

Table 4B. Top Ten Central Cities by Total Number of EITC Earners with Refund Loans, 1999

	Central City	Population Rank	Number of Taxpayers Earning EITC	Number of EITC Earners with RAL	Percentage of EITC Earners with RALs
1	New York, NY	1	690,097	154,041	22.3%
2	Chicago, IL	3	266,395	130,039	48.8
3	Houston, TX	4	193,835	92,254	47.6
4	Los Angeles-Long Beach, CA	2	348,647	86,619	24.8
5	Dallas, TX	8	114,429	62,147	54.3
6	Philadelphia, PA	6	147,451	61,731	41.9
7	Detroit, MI	10	103,371	58,959	57.0
8	San Antonio, TX	9	111,634	54,896	49.2
9	Memphis, TN	18	77,834	51,517	66.2
10	Phoenix-Mesa, AZ	5	106,292	40,436	38.0

Source: 1999 IRS ETA IMF Marketing Database

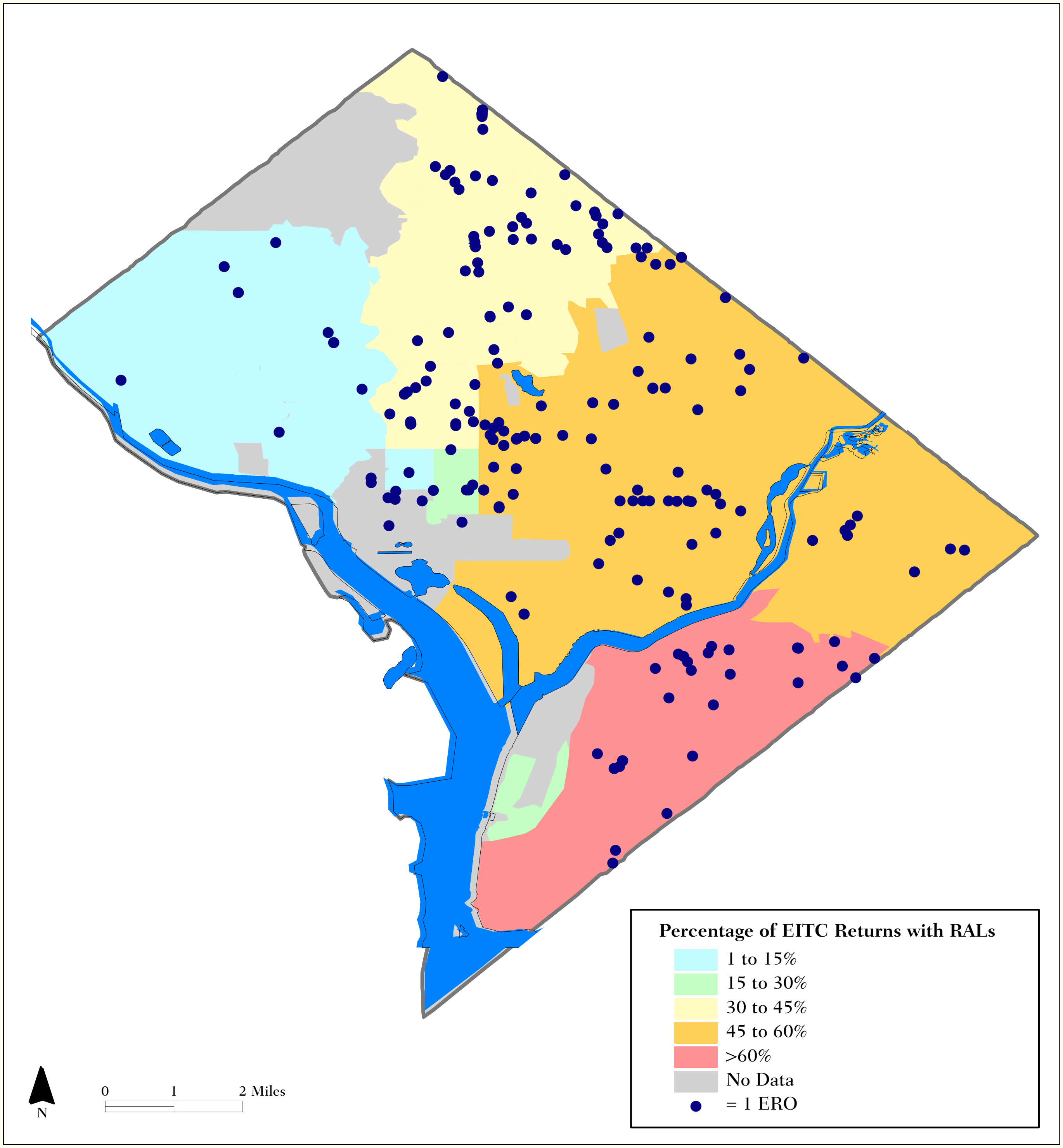
marketing that for-profit tax preparers do for themselves has the beneficial side effect of marketing the EITC; low-income taxpayers who would otherwise be unaware of the credit are no doubt better off receiving their tax refund—minus the associated fees—than they would be if they had never filed a tax return at all.

At the same time, while making no assertions as to what the price of such commercial assistance should be, we must note that $100 is a considerable sum for a low-income family to pay in order to gain access to such an important benefit. We further observe that a high-interest short-term loan secured by a tax refund, in contrast to the preparation and filing of a return, provides little to no benefit to a low-income taxpayer yet imposes an extremely steep price.

What is behind the proliferation of RALs and tax preparation in low-income neighborhoods? Complexity in the tax code is perhaps the most significant driver of the demand for tax preparation services. As H&R Block notes in its annual report, "…historically, changes in tax laws have increased H&R Block's business."[50] That complexity supports industry players other than tax preparation firms and their partners. Accounting firms, estate tax lawyers, and professional financial advisors all benefit when federal and state governments change tax laws, or the IRS changes tax rules.

There is no question, however, that the public interest is not served when a tax credit designed specifically to supplement the earnings of low-income workers with children becomes an important profit center for

Figure 8. Location of Tax Preparers versus Share of EITC Recipients with Refund Loan Washington, D.C., 1999



a multi-billion dollar industry. The annual diversion of EITC dollars to commercial tax preparers defeats the intent of both Congress and the American public in their support for the credit. Congress and the Administration have a clear obligation to consider how changes to the rules governing eligibility for the EITC and the child tax credit could make the filing process less intimidating for low-income families, and reduce filing errors related to the credit.

Beyond reducing complexity, though, the evidence in this report points to four additional opportunities for federal, state and local officials to connect more working Americans to their full EITC earnings.

1. Simplify the EITC and the partially refundable child credit.

Although complexity is an inevitable consequence of using the tax code to achieve public policy aims, the EITC and the refundable child credit are nonetheless needlessly complex. In response to high error rates in EITC claims, the Treasury Department issued a series of recommendations to simplify the rules, some of which were enacted in last year's tax bill. Congress should enact the remainder of these recommendations, including a recent proposal from Treasury to adopt a uniform definition of qualifying child across the tax code.[51]

Moreover, Congress should modify the refundable child credit to simplify the arithmetic involved. As passed, the law requires taxpayers claiming the child credit to calculate both a "refundable" and "nonrefundable" portion. Congress should consider various proposals to simplify the multiplicity of credits currently available to working families in addition to the EITC, including the child care credit, and the additional child credit. These options include merging the various credits into a single "super credit," eliminating a seldom-used child credit that applies only to certain large families and provides little by way of benefits, and lowering the phase-out rate of the EITC so that additional credits become unnecessary.

In addition, the IRS should devise simple, one-page worksheets that can help families complete the necessary paperwork on their own. These worksheets and other guides should be available both on-line on the IRS' website and at libraries, volunteer tax assistance centers and other central locations.

2. Expand free or affordable taxpayer assistance programs for low-income families.

In order to stem the demand for expensive commercial tax preparation services, federal, state and local governments must bolster the supply of free or low-cost tax assistance in low-income communities. The IRS offers several services to assist low-income families with their taxes, but these programs are neither readily available nor well-advertised nor comprehensive. For instance, in tax year 1997, the IRS identified only 101,000 returns completed by the Volunteer Income Tax Assistance (VITA) program, an IRS-sponsored source of free tax preparation assistance for lower-income taxpayers, that included the EITC.[52] The IRS will also calculate a taxpayer's EITC upon request; to take advantage of this service, however, taxpayers with children must complete the necessary schedules and submit their returns. The value added in terms of convenience or speed is therefore minimal.

For FY 2002, Congress appropriated $7 million for low-income taxpayer clinics; these clinics by and large provide legal assistance to individuals attempting to resolve tax disputes, and not, in most instances, general assistance in completing and filing returns. Congress should provide at least this level of support for VITA, if not more, through a grant program to be administered by the IRS.[52] Grants to volunteer tax assistance organizations throughout the U.S. would help them to advertise their services and purchase the computer hardware necessary to e-file returns—a critical service for competing against commercial services and refund loans. A matching requirement for the grants might encourage state governments that levy income taxes to support their own volunteer tax assistance organizations.[54] With costs for preparing a return at a VITA site averaging roughly $25, a $20 million program could support the filing of 800,000 returns for low-income taxpayers annually.[55]

Local officials and community leaders can bolster the capacity of these organizations as well, particularly by recruiting more volunteers to staff their sites. Legal and accounting professional organizations can urge their members to participate in these efforts, and firms can make it easier for professionals to donate their time. Leaders of local community tax preparation strategies can use information from the IRS to identify the neighborhoods where usage of "rapid refund" loans is highest, in order to strategically position free tax assistance sites where they are needed most. Additionally, employers with large numbers of low-wage workers could accommodate free or affordable tax preparation on-site during tax season, ideally promoting linkages to bank accounts at the same time (see #4 below).

3. Make free electronic filing available to lower-income taxpayers, and continue efforts to expedite refund turnaround.

The President's FY2003 budget notes that "…individuals have to pay accountants, buy software, and pay fees just to file their tax return. It should not be so hard to pay taxes." For no group is this more relevant than low-income filers. In light of this, the budget proposed a no-cost option for taxpayers to file their returns online, and termed free filing for citizens with simple tax forms a "priority initiative."[56] Not surprisingly, industry groups immediately criticized the proposal as a government intervention into a private sector business.[57]

The Administration's proposal recognizes that tax filers should not have to pay for a service that, in every respect, constitutes a public accommodation. Online filing provides benefits to taxpayers by simplifying the process of completing a return and expediting refunds and collections. At the same time, it reduces the burden on the government of handling paper returns, and helps move the IRS towards its goal of 80 percent e-filing by 2007.

Over the longer term, the IRS can compete effectively against rapid refund loans by continuing to modernize its computer systems, which could reduce waiting time for direct deposit refunds to two to three days. In concert with that effort, the IRS should work to provide, at a minimum, free web-based online filing for lower-income taxpayers and those filing simple returns like the 1040EZ. Congress should appropriate the funds necessary to ensure that this filing option is available in local libraries, schools, government offices, and volunteer tax assistance centers, and to help the IRS build on its existing outreach efforts to make eligible taxpayers aware of free filing options. The IRS could also do more in the short term to publicize the availability of existing tax preparation and filing software that is free of charge to low-income filers.[58]

4. *Couple tax preparation services with efforts to bank the unbanked.*
The demand for RALs and other products is driven in part by the desire for fast refunds among taxpayers who do not have bank accounts and cannot benefit from direct deposit. Perhaps 4 million families earning the EITC today are "unbanked," and may thus find a rapid refund or refund transfer more appealing than waiting weeks for the IRS to provide a check.[59] A successful effort to combat the demand for high-priced refund-related products must include efforts to help more low-income families gain access to the financial services mainstream through account ownership. Such efforts can also help save these families money they might otherwise have to spend at a check casher.

In 2000 and 2001, Congress appropriated $12 million to the Treasury Department to pilot innovative strategies to help "bank the unbanked." These projects should involve locally-based volunteer income tax assistance organizations working together with banks or credit unions to link lower-income taxpayers to low-cost accounts. Funding from Treasury can help to offset marketing, outreach and training costs for the pilots, and the costs incurred by banks or credit unions in opening the accounts. Additionally, the funds could sponsor financial education classes to teach low-income families the basics of household budgeting and managing debt. Treasury recently announced the first round of awards under the "First Accounts" program, which will support, among other projects, a pilot in Chicago and Detroit to connect 1,000 EITC recipients to bank accounts. Additional support from Congress for this program would permit Treasury to help move a greater number of the 4 million low-income "unbanked" families into successful relationships with mainstream financial institutions.[60]

5. *Promote consumer awareness regarding "rapid refund" loans.*
Many filers may not recognize the real cost of a rapid refund, or know of the options available to them for claiming their tax credit dollars. Raising consumer awareness—through public service announcements, social marketing efforts, or even a simple brochure included with tax forms—can help prevent costly mistakes. The IRS, the new Office of Financial Education at the Treasury Department, and state and local consumer agencies can all play an important role in informing low-income taxpayers about the costs of—and alternatives to—high-priced refund loans. Building on their work around payday lending, state attorneys general and financial institution regulators should also bolster their efforts to educate consumers regarding the true cost of RALs.

VI. Conclusion

The high cost of tax preparation services and related products significantly blunts the effectiveness of the EITC in lifting the incomes of low-wage workers and helping families escape poverty. Every year, nearly $2 billion intended to support working families is diverted to an industry that is increasingly reliant on these low-wage taxpayers. Because the demand for tax preparation services is essentially government-driven, government has an obligation to ease the associated burden on low-income families. Fulfilling that obligation will ensure that families receive the full benefit of the EITC to which they are entitled.

Appendix A. Share of EITC Returns, and EITC Dollars, with RALs in 100 Largest Metro Areas, Cities and Suburbs, 1999

		Region				Central Cities				Suburbs			
	Number of Metro Areas	% of Taxpayers Filing for EITC	EITC Returns with RAL	% EITC with RAL	% EITC Dollars with RAL	% of Taxpayers Filing for EITC	EITC Returns with RAL	% EITC with RAL	% EITC Dollars with RAL	% of Taxpayers Filing for EITC	EITC Returns with RAL	% EITC with RAL	% EITC Dollars with RAL
Census Region													
Northeast	22	13.0%	638,644	28.2%	34.4%	22.2%	324,097	29.4%	34.7%	9.2%	314,547	27.1%	34.2%
Midwest	21	12.1%	828,553	42.7%	51.8%	20.4%	456,095	50.3%	59.6%	8.7%	372,458	35.7%	44.4%
South	34	16.7%	1,819,853	46.1%	54.5%	22.4%	780,524	52.0%	60.3%	14.4%	1,039,329	42.6%	50.8%
West	23	13.8%	673,194	24.9%	30.7%	18.3%	280,588	33.0%	40.2%	12.5%	392,606	23.6%	28.9%
100 Largest Metro Areas	**100**	**14.3%**	**3,960,244**	**36.7%**	**44.4%**	**20.7%**	**1,841,304**	**40.6%**	**48.2%**	**11.6%**	**2,118,940**	**34.0%**	**41.5%**
Metropolitan Area													
Newark, NJ PMSA	NE	13.6%	42,695	39.8%	46.3%	35.1%	15,376	46.7%	52.2%	10.7%	27,319	36.7%	43.4%
Rochester, NY MSA	NE	11.9%	23,419	39.2%	49.0%	29.6%	10,282	55.7%	65.7%	9.4%	13,137	31.8%	40.5%
Harrisburg, PA MSA	NE	9.7%	11,761	38.6%	48.9%	30.4%	3,506	58.4%	68.5%	8.3%	8,255	33.8%	43.3%
Philadelphia, PA-NJ PMSA	NE	12.5%	106,112	38.2%	46.0%	24.5%	61,731	41.9%	48.9%	8.1%	44,381	34.0%	42.3%
Albany, NY MSA	NE	11.2%	16,847	37.9%	48.1%	17.5%	3,679	47.4%	60.2%	10.4%	13,168	35.9%	45.5%
Syracuse, NY MSA	NE	13.1%	15,228	36.7%	46.2%	23.6%	6,594	47.5%	57.6%	10.7%	8,634	31.3%	39.9%
Buffalo, NY MSA	NE	12.4%	23,018	36.0%	45.5%	25.3%	14,741	48.0%	57.6%	8.5%	8,277	24.8%	32.7%
Allentown, PA MSA	NE	9.9%	10,153	34.4%	43.0%	19.8%	4,240	44.3%	52.1%	8.0%	5,913	29.6%	37.9%
New Haven, CT PMSA	NE	9.8%	13,978	34.3%	42.9%	22.5%	3,327	46.3%	55.6%	8.7%	10,651	31.8%	40.0%
Bergen-Passaic, NJ PMSA	NE	11.2%	20,227	32.4%	39.3%		-			11.2%	20,227	32.4%	39.3%
Pittsburgh, PA MSA	NE	11.0%	37,229	31.5%	41.0%	16.4%	10,212	42.4%	53.1%	10.2%	27,017	28.7%	37.8%
Scranton, PA MSA	NE	11.9%	9,937	29.9%	38.2%	15.1%	2,072	39.4%	48.7%	11.4%	7,865	28.1%	36.1%
Jersey City, NJ PMSA	NE	20.1%	15,506	28.8%	33.9%	24.1%	9,338	38.0%	43.2%	17.7%	6,168	21.1%	25.7%
Providence, RI-MA MSA	NE	11.6%	22,570	28.0%	35.7%	23.6%	6,779	37.3%	45.7%	10.1%	15,791	25.3%	32.4%
Monmouth-Ocean, NJ PMSA	NE	7.9%	10,362	27.4%	33.6%		-			7.9%	10,362	27.4%	33.6%
Hartford, CT MSA	NE	9.6%	12,271	27.1%	33.9%	32.1%	4,360	29.1%	34.5%	7.1%	7,911	26.1%	33.6%
Middlesex-Somerset-Hunterdon, NJ PMSA	NE	7.6%	8,341	24.4%	30.5%		-			7.6%	8,341	24.4%	30.5%
Springfield, MA MSA	NE	12.4%	7,961	23.6%	30.4%	22.7%	4,336	32.8%	39.9%	9.6%	3,625	17.6%	23.3%
New York, NY PMSA	NE	20.2%	165,878	22.5%	26.5%	21.9%	154,041	22.3%	26.3%	9.5%	11,837	24.8%	29.5%
Boston, MA-NH PMSA	NE	9.1%	45,214	20.1%	25.5%	15.2%	9,483	24.4%	29.6%	8.4%	35,731	19.2%	24.7%
Nassau-Suffolk, NY PMSA	NE	8.6%	19,937	20.0%	25.4%		-			8.6%	19,937	20.0%	25.4%
Indianapolis, IN MSA	MW	12.5%	47,595	51.2%	60.7%	16.2%	31,150	56.5%	65.8%	9.4%	16,445	43.6%	52.8%
Cincinnati, OH-KY-IN PMSA	MW	11.7%	45,934	49.7%	59.7%	19.3%	19,555	59.3%	70.2%	9.6%	26,379	44.4%	53.5%
Gary, IN PMSA	MW	13.0%	17,342	47.2%	55.7%	34.1%	7,141	62.7%	69.5%	10.2%	10,201	40.2%	48.5%
Columbus, OH MSA	MW	11.3%	38,401	45.2%	55.2%	16.7%	24,145	51.0%	61.2%	8.0%	14,256	38.0%	47.2%
St. Louis, MO-IL MSA	MW	13.5%	71,725	45.0%	54.9%	29.5%	23,448	55.0%	64.2%	11.3%	48,277	41.4%	51.1%
Dayton, OH MSA	MW	11.9%	24,213	44.2%	54.3%	26.9%	8,354	52.1%	61.9%	9.7%	15,859	40.9%	50.9%
Chicago, IL PMSA	MW	13.0%	201,223	42.6%	51.0%	24.5%	130,039	48.8%	57.0%	8.1%	71,184	34.6%	42.4%
Toledo, OH MSA	MW	12.6%	15,243	42.2%	52.6%	17.5%	12,503	46.4%	56.6%	7.0%	2,740	29.8%	39.3%
Detroit, MI PMSA	MW	11.8%	97,083	42.1%	50.6%	32.6%	58,959	57.0%	64.3%	7.8%	38,124	29.9%	37.5%
Milwaukee, WI PMSA	MW	10.7%	30,819	41.5%	51.8%	21.8%	24,214	49.7%	59.4%	5.5%	6,605	25.8%	34.5%
Oklahoma City, OK MSA	MW	16.9%	31,914	41.2%	50.1%	19.3%	18,341	45.1%	54.2%	14.9%	13,573	36.9%	45.4%
Tulsa, OK MSA	MW	16.1%	22,101	40.9%	50.4%	15.7%	10,164	42.2%	52.4%	16.5%	11,937	39.9%	48.8%
Cleveland, OH PMSA	MW	12.2%	53,323	40.5%	49.9%	29.3%	25,977	50.2%	58.8%	8.9%	27,346	34.2%	43.4%

	Number of Metro Areas	Region: % of Taxpayers Filing for EITC	Region: EITC Returns with RAL	Region: % EITC with RAL	Region: % EITC Dollars with RAL	Central Cities: % of Taxpayers Filing for EITC	Central Cities: EITC Returns with RAL	Central Cities: % EITC with RAL	Central Cities: % EITC Dollars with RAL	Suburbs: % of Taxpayers Filing for EITC	Suburbs: EITC Returns with RAL	Suburbs: % EITC with RAL	Suburbs: % EITC Dollars with RAL
Kansas City, MO-KS MSA	MW	11.8%	36,036	39.4%	48.2%	19.2%	15,717	47.2%	55.9%	9.7%	20,319	34.9%	43.3%
Omaha, NE-IA MSA	MW	11.1%	13,124	37.9%	47.4%	12.4%	9,446	40.2%	50.5%	9.0%	3,678	33.0%	40.9%
Grand Rapids, MI MSA	MW	10.6%	19,179	37.4%	46.3%	18.3%	4,839	43.1%	52.4%	9.5%	14,340	35.8%	44.5%
Akron, OH PMSA	MW	10.9%	13,549	36.8%	46.7%	20.1%	8,553	46.7%	56.5%	7.5%	4,996	27.0%	35.6%
Wichita, KS MSA	MW	12.2%	9,846	35.9%	43.8%	14.4%	7,296	38.0%	46.0%	9.0%	2,550	31.0%	38.6%
Youngstown, OH MSA	MW	13.5%	13,379	35.9%	45.0%	24.6%	4,459	46.9%	56.9%	11.7%	8,920	32.1%	40.5%
Ann Arbor, MI PMSA	MW	7.1%	4,926	29.1%	37.1%	4.2%	198	15.9%	23.1%	7.5%	4,728	30.1%	37.9%
Minneapolis-St. Paul, MN-WI MSA	MW	7.7%	21,598	21.6%	29.3%	14.2%	11,597	29.7%	38.9%	6.0%	10,001	16.4%	22.6%
Memphis, TN-AR-MS MSA	S	24.1%	77,285	63.6%	71.2%	31.5%	51,517	66.2%	73.6%	17.0%	25,768	58.9%	66.8%
Charlotte, NC-SC MSA	S	15.0%	57,672	57.9%	66.1%	15.3%	20,371	58.2%	65.9%	14.8%	37,301	57.7%	66.2%
Greensboro-Winston-Salem, NC MSA	S	15.9%	51,005	57.4%	66.4%	16.8%	11,850	63.2%	73.0%	15.7%	39,155	55.8%	64.6%
Baton Rouge, LA MSA	S	21.7%	30,430	57.4%	66.2%	25.8%	13,438	62.3%	71.2%	19.5%	16,992	54.0%	62.7%
Little Rock, AR MSA	S	18.0%	25,492	56.4%	66.1%	19.4%	8,969	63.3%	73.3%	17.5%	16,523	53.2%	62.7%
Birmingham, AL MSA	S	19.4%	42,160	55.6%	64.1%	36.3%	20,961	63.9%	71.5%	14.3%	21,199	49.3%	57.9%
Greenville, SC MSA	S	17.0%	39,628	55.6%	64.6%	27.9%	778	69.9%	80.1%	16.9%	38,850	55.3%	64.3%
Charleston, SC MSA	S	19.2%	25,004	55.2%	64.5%	16.5%	5,784	55.9%	67.1%	20.2%	19,220	55.0%	63.7%
Columbia, SC MSA	S	17.2%	22,040	53.8%	63.7%	17.7%	4,307	58.2%	68.5%	17.1%	17,733	52.9%	62.7%
Norfolk-Virginia Beach-Newport News, VA-NC MSA	S	16.8%	60,656	53.6%	62.5%	17.5%	34,051	54.0%	62.9%	16.0%	26,605	53.1%	62.1%
Jacksonville, FL MSA	S	17.2%	45,717	53.5%	62.8%	19.6%	36,055	57.7%	66.7%	12.9%	9,662	42.1%	51.3%
Raleigh-Durham, NC MSA	S	12.1%	33,299	52.9%	62.3%	15.8%	10,951	59.0%	68.2%	11.0%	22,348	50.3%	59.8%
Mobile, AL MSA	S	23.7%	27,972	52.7%	61.2%	34.3%	14,918	60.5%	67.8%	18.7%	13,054	46.0%	54.8%
New Orleans, LA MSA	S	25.2%	73,356	52.5%	60.7%	36.3%	40,082	58.9%	65.9%	19.6%	33,274	46.4%	55.2%
Richmond, VA MSA	S	13.4%	31,827	51.4%	61.7%	21.8%	6,651	57.2%	68.8%	12.4%	25,176	50.0%	60.1%
McAllen, TX MSA	S	48.8%	47,168	51.0%	56.8%	35.5%	6,152	44.4%	51.3%	52.2%	41,016	52.1%	57.7%
Atlanta, GA MSA	S	15.2%	136,685	50.7%	59.3%	24.7%	24,679	62.8%	71.8%	14.3%	112,006	48.6%	57.0%
Nashville, TN MSA	S	14.0%	39,680	50.5%	59.7%	17.1%	23,809	54.9%	64.7%	11.4%	15,871	45.0%	53.5%
Fort Worth-Arlington, TX PMSA	S	16.0%	57,001	49.5%	57.2%	20.2%	39,449	53.5%	61.2%	11.7%	17,552	42.2%	49.7%
Dallas, TX PMSA	S	16.1%	118,549	49.2%	56.2%	23.8%	62,147	54.3%	60.8%	12.4%	56,402	44.6%	51.8%
San Antonio, TX MSA	S	22.5%	74,569	48.7%	57.0%	24.2%	54,896	49.2%	57.5%	19.0%	19,673	47.3%	55.5%
Austin, TX MSA	S	12.7%	32,086	46.7%	56.2%	15.1%	17,741	49.0%	59.4%	10.8%	14,345	44.1%	52.8%
Louisville, KY-IN MSA	S	14.2%	31,610	46.3%	56.5%	23.7%	14,433	54.4%	64.8%	11.3%	17,177	41.2%	50.8%
El Paso, TX MSA	S	36.1%	44,645	45.6%	52.3%	33.8%	34,543	44.1%	51.0%	49.8%	10,102	51.7%	57.0%
Houston, TX PMSA	S	19.4%	149,254	45.4%	52.3%	24.6%	92,254	47.6%	54.7%	14.9%	57,000	42.2%	48.7%
Knoxville, TN MSA	S	15.1%	19,660	43.2%	52.2%	17.6%	5,775	47.8%	58.3%	14.4%	13,885	41.6%	50.1%
Tampa-St. Petersburg, FL MSA	S	15.6%	71,065	43.2%	52.4%	18.2%	26,953	50.7%	60.7%	14.5%	44,112	39.6%	48.3%
Baltimore, MD PMSA	S	13.8%	66,308	43.0%	51.8%	28.2%	39,206	52.2%	60.7%	9.3%	27,102	34.2%	42.4%
Wilmington, DE-MD PMSA	S	11.2%	12,697	42.8%	52.2%	26.1%	3,335	55.7%	66.6%	9.8%	9,362	39.6%	48.3%
Orlando, FL MSA	S	17.2%	53,371	41.4%	49.3%	24.6%	7,577	49.9%	58.1%	16.5%	45,794	40.2%	48.0%
Sarasota, FL MSA	S	11.9%	12,079	37.1%	46.6%	14.5%	636	34.6%	43.4%	11.7%	11,443	37.2%	46.7%
Washington, DC-MD-VA-WV PMSA	S	10.4%	82,297	35.2%	42.8%	19.7%	23,515	48.5%	57.5%	9.3%	58,782	31.8%	38.7%
West Palm Beach, FL MSA	S	13.2%	22,801	33.5%	41.7%	22.4%	4,874	42.1%	50.4%	12.1%	17,927	31.7%	39.8%
Fort Lauderdale, FL PMSA	S	15.8%	35,817	31.4%	38.9%	20.9%	8,061	41.1%	50.3%	15.1%	27,756	29.4%	36.5%
Miami, FL PMSA	S	27.5%	68,968	27.2%	34.2%	32.9%	9,806	24.5%	31.9%	26.6%	59,162	27.7%	34.6%

		Region				Central Cities				Suburbs			
	Number of Metro Areas	% of Taxpayers Filing for EITC	EITC Returns with RAL	% EITC with RAL	% EITC Dollars with RAL	% of Taxpayers Filing for EITC	EITC Returns with RAL	% EITC with RAL	% EITC Dollars with RAL	% of Taxpayers Filing for EITC	EITC Returns with RAL	% EITC with RAL	% EITC Dollars with RAL
Las Vegas, NV-AZ MSA	W	14.6%	38,109	39.6%	48.6%	15.1%	10,773	40.7%	49.6%	14.5%	27,336	39.1%	48.2%
Tacoma, WA PMSA	W	12.2%	13,342	36.7%	43.9%	15.4%	4,873	40.3%	47.7%	11.1%	8,469	34.9%	41.9%
Phoenix-Mesa, AZ MSA	W	13.7%	62,329	35.7%	43.4%	17.0%	40,436	38.0%	45.4%	10.6%	21,893	32.1%	40.1%
Bakersfield, CA MSA	W	26.4%	19,586	34.5%	39.6%	24.8%	6,709	43.1%	49.2%	27.1%	12,877	31.3%	36.0%
Tucson, AZ MSA	W	16.1%	19,027	34.5%	43.4%	18.2%	10,469	34.0%	43.9%	14.0%	8,558	35.2%	42.8%
Sacramento, CA PMSA	W	12.9%	27,610	31.4%	37.1%	18.4%	12,051	36.1%	41.4%	10.9%	15,559	28.5%	34.3%
Albuquerque, NM MSA	W	17.3%	16,435	30.9%	39.4%	14.5%	5,840	28.4%	38.0%	19.7%	10,595	32.4%	40.2%
Stockton, CA MSA	W	18.5%	11,633	30.3%	34.9%	22.8%	6,070	36.1%	41.2%	16.1%	5,563	25.8%	29.8%
Denver, CO PMSA	W	10.2%	27,735	28.6%	37.0%	15.9%	10,831	31.8%	41.4%	8.5%	16,904	26.8%	34.5%
Riverside-San Bernardino, CA PMSA	W	20.3%	64,410	27.1%	32.1%	24.6%	12,981	34.5%	40.0%	19.6%	51,429	25.8%	30.6%
Fresno, CA MSA	W	26.7%	22,713	27.0%	31.4%	23.0%	6,357	28.6%	33.2%	28.4%	16,356	26.4%	30.7%
Vallejo, CA PMSA	W	11.0%	6,213	26.1%	32.2%	14.2%	1,836	34.5%	42.2%	10.4%	4,377	23.6%	29.3%
Seattle-Bellevue, WA PMSA	W	7.8%	22,701	25.4%	32.5%	7.5%	6,994	21.7%	30.0%	8.0%	15,707	27.6%	33.8%
Salt Lake City, UT MSA	W	10.8%	15,206	25.4%	31.7%	14.8%	2,217	27.6%	35.1%	10.3%	12,989	25.0%	31.2%
Oakland, CA PMSA	W	9.6%	21,803	23.1%	28.5%	15.3%	7,765	28.3%	34.7%	8.4%	14,038	20.9%	25.8%
San Diego, CA MSA	W	13.7%	37,738	22.9%	27.7%	13.9%	17,057	22.0%	26.8%	13.5%	20,681	23.8%	28.5%
Los Angeles-Long Beach, CA PMSA	W	20.9%	173,951	22.9%	27.8%	23.8%	86,619	24.8%	30.5%	18.9%	87,332	21.3%	25.6%
Ventura, CA PMSA	W	12.9%	8,823	21.9%	26.7%	8.6%	613	21.3%	27.4%	13.4%	8,210	21.9%	26.6%
Honolulu, HI MSA	W	10.8%	8,859	21.0%	27.7%	9.9%	2,546	16.2%	22.4%	11.4%	6,313	23.9%	30.6%
Portland-Vancouver, OR-WA PMSA	W	10.1%	15,819	18.6%	24.1%	12.1%	7,543	21.3%	28.6%	9.1%	8,276	16.7%	21.1%
Orange County (Santa Ana-Anaheim-Irvine), CA PMSA	W	12.3%	24,989	17.9%	22.7%	19.6%	12,196	21.9%	26.7%	9.9%	12,793	15.2%	19.6%
San Jose, CA PMSA	W	7.7%	7,433	13.7%	15.8%	10.3%	4,145	13.5%	15.3%	5.8%	3,288	13.9%	16.6%
San Francisco, CA PMSA	W	7.1%	6,730	11.2%	14.2%	8.4%	3,667	10.7%	13.8%	5.9%	3,063	11.8%	14.8%

Source: 1999 IRS ETA IMF Marketing Database

Endnotes

1 Alan Berube and Benjamin Forman are, respectively, senior research analyst and research assistant at the Brookings Institution Center on Urban and Metropolitan Policy. Anne Kim and Megan Burns are director and policy assistant at the Progressive Policy Institute's Work, Family and Community Project.

2 Alan Berube and Benjamin Forman. 2001. "A Local Ladder for the Working Poor: The Impact of the Earned Income Tax Credit in U.S. Metropolitan Areas." Washington, D.C.: Brookings Institution Center on Urban and Metropolitan Policy (September).

3 Low-income filers eligible to have at least a portion of the child tax credit refunded to them must now complete Form 8812 along with Form 1040 to claim this credit (in addition to Schedule EIC in order to claim the EITC).

4 Katherin Ross Phillips. 2001. "Who Knows About the Earned Income Tax Credit?" New Federalism Brief B-27. Washington, D.C.: Urban Institute (January).

5 "Earned Income Tax Credit Effectiveness and Program Management FY 1998 – FY 2002." Department of the Treasury, Internal Revenue Service, February 28, 2002.

6 Timothy M. Smeeding, Katherin Ross Phillips, and Michael O'Connor. 2000. "The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility," Working Paper Series No. 13. Washington, D.C.: Center for Policy Research. See **http://www-cpr.mawell.syr.edu/cprwps/pdf/wp13.pdf**.

7 Of the 129,783,221 individual income tax returns that were filed in 2001, 40,245,455 were filed electronically. See IRS Data Book 2001, available at **www.irs.gov**.

8 For more information on the IRS data used for EITC calculations, refer to Berube and Forman (2001).

9 Press release, dated April 27, 2001, available at **www.jacksonhewitt.com**. Jackson Hewitt is a subsidiary of Cendant Corp., which also owns Avis, the car rental company, as well as a number of well-known hotel franchises such as Ramada Inn and Howard Johnson's.

10 Interview with NATP spokesperson, October 25, 2001. According to NATP, the IRS reported that 299,021 separate individuals submitted returns as paid tax preparers this year.

11 See company information available at **www.jacksonhewitt.com**; see also Form 10-K/A, filed by Cendant Corp. with the Securities and Exchange Commission on July 3, 2001, for the fiscal year ended December 31, 2000.

12 Form S-1/A filed by Jackson Hewitt Inc. (1997). In 1997, Jackson Hewitt prepared 875,000 tax returns.

13 Form 10-K405 filed by H&R Block Inc. (2001).

14 Press release, dated April 27, 2001.

15 Form S-1/A filed by Jackson Hewitt Inc. (1997).

16 See Form 10-Q filed by H&R Block Inc. with the Securities and Exchange Commission on December 14, 2001.

17 The state laws from which national banks are exempt include usury laws that cap the permissible interest rate on consumer loans. These banks are, however, subject to federal Truth in Lending laws that require them to disclose the APR and finance charge associated with the loan. For more information on these relationships, as well as on how RALs work, see Chi Chi Wu, Jean Ann Fox and Elizabeth Reunart. 2002. "Tax Preparers Peddle High Priced Tax Refund Loans." Washington, D.C.: Consumer Federation of America and the National Consumer Law Center (January).

18 See, e.g., Form S-1/A filed by Jackson Hewitt Inc. with the Securities and Exchange Commission on July 11, 1997.

19 See, e.g., Form 10-K405 filed by H&R Block Inc. with the Securities and Exchange Commission on July 30, 2001, for the fiscal year ended April 30, 2001.

20 Form 10-K405 filed by H&R Block Inc. (2001).

21 Form 10-K405 of H&R Block Inc. (2001).

22 Documentation on file with the authors.

23 The documentation preparation fees appear to include those for filing the return electronically.

24 The APR is calculated as the price of the credit ($121) as a percentage of the principal ($2,500)—4.84 percent—divided by the term for which the loan is outstanding (1/52 of a year) = 251 percent.

25 Wu, Fox and Reunart (2002).

26 Because outlets are independently owned and operated, fees vary. Of eight Jackson Hewitt stores contacted in our informal survey of Washington, D.C. tax preparers, four reported charging a flat application fee between $27 and $85, plus a finance charge equal to two to three percent of the refund. One service quoted a flat rate of $98, and another store estimated that total fees for a RAL would vary between $35 and $95. Two stores declined to give an estimate.

27 Averages calculated using the low and high ends of price ranges reported. Both exclude a $700 price reported by one respondent.

28 Five of these respondents refused to quote a price; the highest price quoted was $65.

29 This percentage includes the costs for filing a DC state return. Ten states and the District of Columbia offer a refundable earned income credit that builds on the federal EITC and can increase a lower-income family's refund. The additional refund amount is not reflected in this calculation.

30 Arthur B. Kennickell, Martha Starr-McCluer, and Brian Surette. 2000. "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances." *Federal Reserve Bulletin* (January).

31 While the firm's average fee for check cashing is 2.2 percent of the face value, a recent report notes that ACE charges up to 4 percent plus a $3 first-time "membership" fee for tax refund and RAL checks. Wu, Fox and Reunart (2002).

32 A 2000 study conducted for the U.S. Treasury Department found that check cashing chains in four different markets charged an average fee of 2 percent to cash government-issued checks. "Survey of Non-Bank Financial Institutions for the Department of the Treasury (Final Report)." See **www.treas.gov/press/releases/docs/nbfirpt.pdf**.

33 Form 10-K405 filed by H&R Block Inc. (2001).

34 Form S-1/A of Jackson Hewitt.

35 In fact, a prospectus for the company's initial public offering warned investors of its dependence on this particular market niche; the prospectus stated that "the adoption of legislation that would significantly reduce or eliminate electronic filings, the number of tax returns filed by Jackson Hewitt's customer base of lower income taxpayers, or the availability of accelerated refunds or EITCs, would materially adversely affect" the company's business.

36 Form 10-K405 filed by Household International Inc. with the Securities and Exchange Commission on March 13, 2002, for the fiscal year ended December 31, 2001.

37 Form 10-K405 filed by Household International Inc. with the Securities and Exchange Commission on March 28, 2001, for the fiscal year ended December 31, 2000; Form 10-K405 of Household International Inc. (2002).

38 Form 10-K405 of Household International Inc. (2002).

39 Form 10-K405 filed by Pacific Capital Bancorp with the Securities and Exchange Commission on March 16, 2001, for the fiscal year ended December 31, 2000.

40 As noted previously, the ERO database does not reflect "fly-by-night" tax preparers that operate seasonally in low-income neighborhoods. While these preparers are not registered to file returns electronically with the IRS, and are not listed in local phone directories, anecdotal evidence suggests that their fees are commensurate with those found at other preparers. Many will even make high-priced loans to customers based on their anticipated refund, despite the fact that they cannot receive the "debt indicator" from the IRS without filing their clients' returns electronically.

41 "Earned Income Tax Credit Effectiveness and Program Management, FY 1998 – FY 2002." Department of the Treasury, Internal Revenue Service. February 28, 2002.

42 In part, the relationship between EITC and usage of electronic filing may reflect differences between the types of returns that low-income and high-income taxpayers submit to the IRS. Some higher-income taxpayers must file several complicated schedules that, at least in 1999, the IRS was not able to process electronically. Nonetheless, it is clear that zip codes with higher shares of families earning the EITC exhibit higher demand for e-filing.

43 There were, however, 17 city zip codes in which more than 55 percent of families earned the EITC and in which ERO penetration was very high. Located in such cities as Fresno, El Paso, New Orleans, St. Louis, Milwaukee and Philadelphia, these zip codes were home to more than 20 EROs for every 10,000 filers.

44 Another caveat is that the preparation and filing fees from our informal survey include those for state returns as well. Fees for preparing and filing the federal return alone may be lower. At the same time, however, the $1.75 billion estimate does not include EITC amounts diverted for refund transfers, non-electronically filed returns, and check cashing fees--sums that would add considerably to this total.

45 In metropolitan zip codes where less than 10 percent of taxpayers received the EITC in 1999, the average EITC earned was $1,384. In metropolitan zip codes where more than 40 percent of taxpayers earned the credit, the average EITC earned that year was $1,875.

46 Since most individuals earning the EITC are in the "phase-out" range of the credit, a higher average EITC amount implies a lower average income. See Berube and Forman (2001) for more details on the structure of the credit.

47 While most of these places were located in and around cities in the Southeast U.S., an alarming number were located in American Indian communities, including: the Pine Ridge Reservation in South Dakota; the Redlake Reservation in Minnesota; the Blackfeet Nation in Montana; the Gila River Community in Arizona; and the Mescalero Apache Reservation in New Mexico. Efforts to stem the demand for rapid refund loans must include a focus on Indian Country.

48 It is worth noting, however, that the error rate on returns that include the EITC and are filed by professional tax preparers is no better than the error rate on self-filed EITC returns. Janet McCubbin, "EITC Non-Compliance: The Determinants of the Misreporting of Children." 53 *National Tax Journal* 1135.

49 In tax year 2000, the chances of audit for a taxpayer seeking the EITC were about 1 in 47. For other taxpayers, the odds of audit were 1 in 366. David Cay Johnston, "IRS Audits of Working Poor Increase," *The New York Times,* March 1, 2002 (C2).

50 Form 10-K405 filed by H&R Block Inc. with the Securities and Exchange Commission on July 28, 2000, for the fiscal year ended April 30, 2000.

51 Proposal for a Uniform Definition of Qualifying Child. Department of the Treasury, April 2002. Congress might consider the views of IRS Commissioner Charles Rossotti: "To achieve significant reduction in taxpayer and IRS burden, Congress must enact a uniform definition of a qualifying child that is applicable to all tax provisions that key off family status." Statement of IRS Director Charles Rossotti before the House Government Reform Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, April 15, 2002 (quoting Taxpayer Advocate Nina E. Olson).

52 Michael O'Connor. 2001. "Tax Preparation Services for Lower-Income Filers: A Glass Half Full, or Half Empty?" Tax Notes Today 5-106 (5 Jan 2001). The IRS identified 3.6 million taxpayers assisted through VITA and Tax Counseling for the Elderly (TCE) in fiscal year 2001, though there was no breakdown on the number of these returns that included EITC claims.

53 S. 802, introduced in April 2001 by Senator Jeff Bingaman of New Mexico, authorizes a "no-year" VITA appropriation of $6 million.

54 For a further description of what such a grant program might look like, see O'Connor (2001).

55 O'Connor (2001). O'Connor, a founder of one of the largest VITA programs in the U.S., developed the $25 estimate.

56 Budget of the United States Government, Fiscal Year 2003, pp. 9, 247.

57 Glenn Kessler, "IRS Plans to Offer Tax Filing on Web; Opponents Say Proposal Raises Privacy Issues, Interferes With Tax Preparers," *The Washington Post,* January 26, 2002 (A6).

58 For example, Intuit, the financial software company, offers free online tax software and filing services for anyone who earns less than $25,000 a year.

59 Estimated as 22 percent of 19 million families earning the credit in 2000. Kennickell et al. (2000).

60 For more information on the an initial pilot of this sort in the Chicago area, see "Money in the Bank: The Extra Credit Savings Program," available at **www.centerforlaw.org/pdfs/Money_in_the_bank.pdf**.

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