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Use of Refund Anticipation Loans by Earned Income Tax Credit Filers in Central City Milwaukee Neighborhoods

by Lois M. Quinn, Employment and Training Institute, University of Wisconsin-Milwaukee, June 2002.

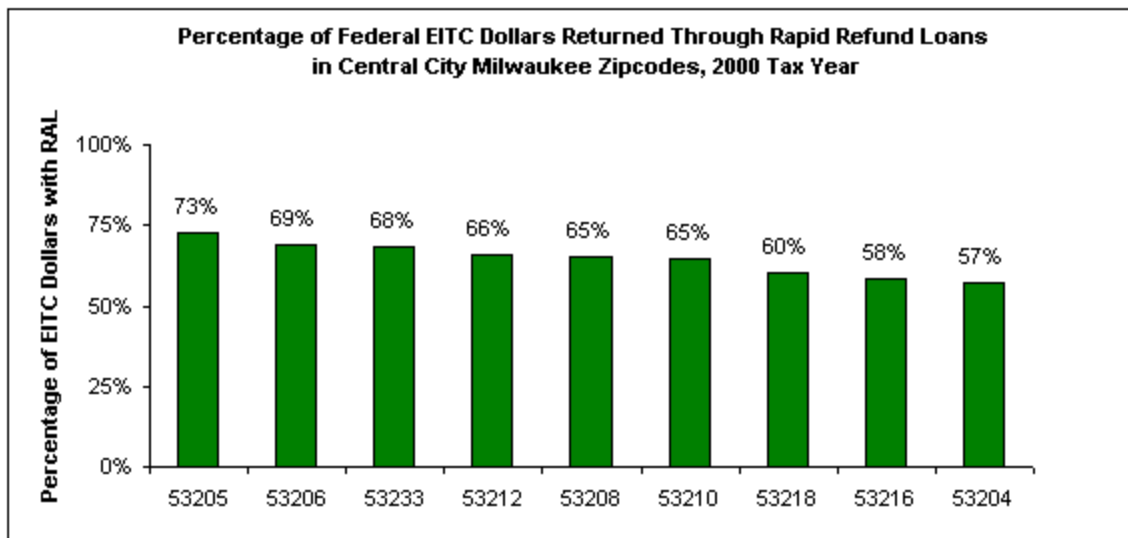
The Brookings Institution Center on Urban and Metropolitan Policy and the Progressive Policy Institute issued a study on "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC," analyzing the spatial distribution of federal earned income tax filers and their use of "rapid refund loans" in the nation's 100 largest metropolitan areas. These rapid refund loans are similar to "payday loans." Companies advance money based on the worker's anticipated income tax refund, and the loan is repaid once the Internal Revenue Service issues the refund payment. Tax filers obtaining RALs usually pay steep charges to receive their tax refunds a few days or weeks early -- with interest rates often as high as 250 percent. By contrast, the Internal Revenue Service trains VITA (Volunteer Income Tax Assistance) volunteers who provide free tax preparation assistance at many area libraries and community agency sites.

This report, prepared by the University of Wisconsin-Milwaukee Employment and Training Institute in cooperation with The Brookings Institution, reviews the use of rapid refund loans by zipcode area in central city Milwaukee neighborhoods. The analysis utilizes year 2000 income tax data files obtained by Brookings staff from the U.S. Internal Revenue Service. Nine central city Milwaukee zipcodes (53204, 53205, 53206, 53208, 53210, 53212, 53216, 53218 and 53233) in the heart of the Community Development Block Grant (CDBG) neighborhoods were analyzed, as well as other predominantly City of Milwaukee zipcodes and predominantly suburban Milwaukee County zipcodes. [For research on EITC usage rates, see [Usage of the Earned Income Tax Credit by Employed Families in Milwaukee County](#), April 2000.]

Findings

- According to the national research, over half of all U.S. tax filers use commercial tax preparers, but the marketing of refund anticipation loans is aimed mainly at lower income families eligible for the earned income tax credit and without personal bank accounts in which to receive a direct deposit tax refund. In Milwaukee County 29,458 single and married tax filers claiming the federal earned income tax credit used tax preparers and borrowed on their credits through RALs prior to receiving them from IRS.
- The Brookings/PPI study found that national tax preparation chains typically charge at least \$100 fees for simple tax preparation and filing, plus an additional \$75 to \$100 for a "rapid refund." At these rates, lower-income Milwaukee County workers who used commercial tax preparers and RALs rather than the free VITA services may have lost \$5.5 million in tax refunds and federal EITC payments in 2000, or about 9 percent of their federal EITC payment. Additional monies may have been lost in rapid refund loans for state earned income tax credits. In many cases, companies also charge a percentage fee to cash the refund loan checks.

- Of \$61.8 million in federal earned income tax credits paid to workers in central city Milwaukee neighborhoods, \$39.4 million (64 percent) was returned to taxpayers through rapid refund loans. **Taxpayers in the central city neighborhoods, where use of RALs is highest, lost an estimated \$3.5 million in tax refunds and federal EITC payments by using commercial preparers and RALs rather than free VITA services.**
- On the near northside, zipcode 53205 had the highest percentage of EITC monies diverted to refund anticipation loans, with 73 percent of EITC refunds returned through RALs.



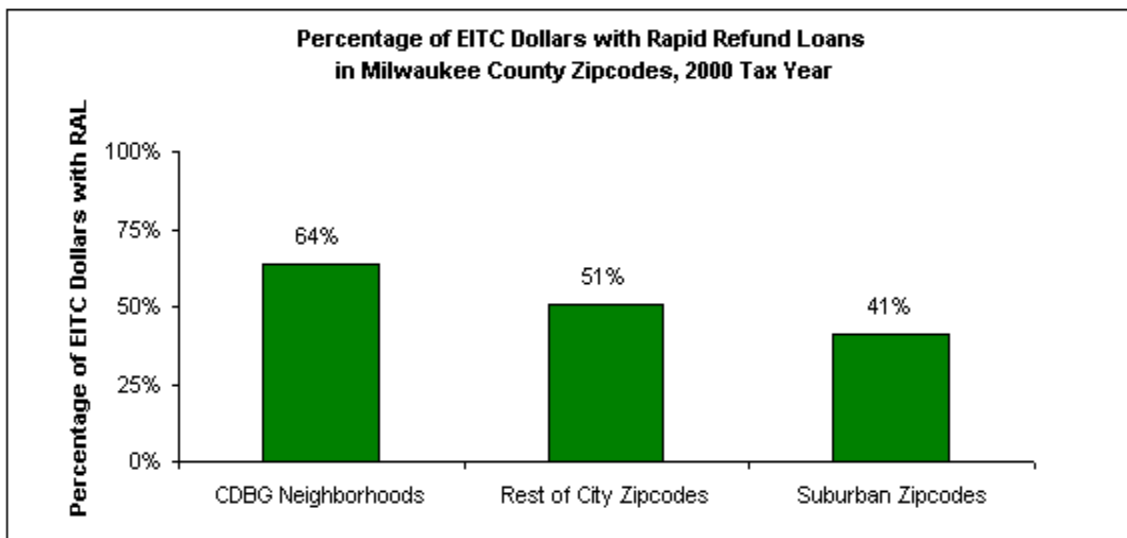
- In central city Milwaukee neighborhoods, 55 percent of workers claiming the earned income tax credit used tax preparers and borrowed on their credits through RALs prior to receiving them from IRS. A total of 18,888 central city tax filers (out of 34,335 receiving the federal EITC) used RALs to obtain their 2000 income tax payments a few days or weeks in advance, but at a high interest rate.

Use of Rapid Refund Loans by Federal Earned Income Tax Credit Filers in Central City Milwaukee Zipcode Areas, 2000 Tax Year

Zipcode	Taxpayers Earning the Federal EITC	% of EITC Earners Using Rapid Refund Loans	Federal EITC Dollars	% of EITC Dollars with Rapid Refund Loans
53204	4,483	48.9%	\$7,966,951	57.3%
53205	1,815	63.9%	\$3,430,657	72.6%
53206	5,363	61.0%	\$9,842,872	69.2%
53208	4,233	57.1%	\$7,504,418	65.4%
53210	4,182	56.3%	\$7,812,858	64.6%
53212	4,297	55.7%	\$7,552,430	65.6%
53216	4,110	49.8%	\$7,197,116	58.4%
53218	4,934	51.6%	\$9,042,866	60.1%
53233	<u>918</u>	55.0%	<u>\$1,455,558</u>	68.2%
TOTAL	34,335	55.0%	\$61,805,726	63.8%

Source: U.S. Internal Revenue Service data runs for The Brookings Institution.

- The use of refund anticipation loans is a problem not just in the central city, but throughout Milwaukee County. Forty-one percent of the earned income tax credit payments to lower-income workers in suburban areas of the county were also diverted to rapid refund loans.



- A third of suburban workers claiming the EITC (5,805 tax filers) lost a portion of their credits through rapid refund loans as did 18,888 workers in the CDBG central city neighborhoods and 4,765 other city residents outside the CDBG.

- The Brookings Institution/Progressive Policy Institute study reported that Milwaukee's usage of RALs was typical of the Midwest region: in the Milwaukee metro area, 52 percent of federal EITC dollars were returned with RALs - the same percentage as for the region. Milwaukee ranked 31st among the 100 largest metropolitan areas in the percentage of taxpayers filing for the EITC who used rapid refund loans (41.5 percent).

Recommendations of the Brookings/PPI Report

The authors of The Brookings Institution/Progressive Policy Institute study recommend several policy changes to reduce the use of RALs and erosion of tax benefits for working Americans.

1. Simplify the IRS forms and instructions for the EITC and the partially refundable child credit.
2. Expand free or affordable taxpayer assistance programs for low- income families.
3. Make free electronic filing available to lower-income taxpayers and continue efforts to expedite refund turnaround time for tax refunds.
4. Couple tax preparation services with efforts to bank the "unbanked."
5. Promote consumer awareness regarding the costs of "rapid refund" loans.

For details on these recommendations, see the following reports:

- Alan Berube, Anne Kim, Benjamin Forman and Megan Burns, "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC" (The Brookings Institution and the Progressive Policy Institute, May 2002).
- Anne Kim and Alan Berube, "Fast Cash for the Tax Man," **Blueprint Magazine**, May 21, 2002.