Fast Cash, Less Savings

Refund Anticipation Loans in North Carolina

A Policy Report

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Executive Summary

RALs compromise the purpose of the Earned Income Tax Credit (EITC). In 2006, the EITC returned $1,577,614,579 to North Carolina households - an average credit of $2,012 per household. While the EITC has been lauded by experts and promoted by legislators, its take-up rate is not increasing. About 20.5 percent of households got the EITC in 2003. The share is 4/10ths of a percentage point lower in 2006.

RALs and RACs take money out of EITC recipient refunds. More than 60.1 percent and 57.6 percent of EITC filers used one of these products in 2005 and 2006, respectively.

The use of RALs has declined in North Carolina.
About 472,000 filers took out a RAL in 2006. This is a decline from 2003, when more 625,000 used a RAL.
Fewer low-income filers are using RALs. Whereas almost one in four used one in 2003, only 17.8 percent took a RAL in 2006. The numbers are also trending in a positive direction for EITC recipients. Whereas more than half had a RAL in 2003, in 2006, slightly less than 40 percent took out a RAL.

The change probably stems from the introduction of a better product – the Refund Anticipation Check (RAC). Approximately 336,000 North Carolina filers opted for a RAC in 2006.

RALs hurt low-income and minority communities
More than 88 percent of RALs originated in North Carolina in 2006 went to low-income households.

Majority-minority census tracts account for almost forty percent of all RALs, even though they only contain 16 percent of the state's population.

Communities with the highest rates of RAL usage are those with more people of color.

This is both a rural and an urban issue.
Communities with the highest percent of RAL use are most frequently located in rural North Carolina. Zip codes with the highest number of RALs are in our cities. Greenville has the most impacted zip code, but cities including Charlotte, Greensboro, Raleigh, Fayetteville, Raleigh and Lumberton are all witnessing this product draw funds out of their neighborhoods.

The means of addressing this issue are very attainable.
The RAL depends upon the complicit support of the Internal Revenue Service. The IRS debt indicator, if stopped, would probably thwart this practice entirely. Consumers would shift to less-expensive RACs. Some of the funders depend upon TARP money. Treasury should place constraints on funds to stop this use.
VITA sites provide free tax prep, e-filing, and direct deposit. They need better marketing. Many would do well to develop institutional partnerships with government, social workers, and the ESC.

Refund Anticipation Loans (RALs) continue to sap dollars from working families in North Carolina. Tax policy has left a gaping hole in the delivery of tax credits for working families, a space that has been filled by private tax preparers. In 2006, more than 472,000 households in North Carolina used a RAL for their tax filing.

RALs compromise the purpose of the Earned Income Tax Credit (EITC). In 2006, about two in five EITC recipients took out a RAL. This is actually the lowest scare in four years. However, one in five utilized a refund anticipation check. The result is that RALs and RACs take money out of EITC recipient refunds more often than not – 60.1 percent in 2005 and 57.6 percent in 2006.

The presence of RALs matters because it mutes the value of our nation's most successful anti-poverty program, the EITC. It is a simple system, ingeniously delivered through tax returns, that operates with relatively minimal administrative costs. It targets money where it is needed – mainly to working households with dependent children. More than 88 percent of RALs originated in North Carolina in 2006 went to low-income households. As time passes, the RAL is actually becoming more linked to poor families. In 2003, about 82.4 percent of RALs were for LMI households, but that share has risen in each subsequent year.

In North Carolina, The EITC offers significant opportunities for low-income working families. Federal EITC dollars continue to help these households build wealth. In 2006, the last year for which complete data is available, the EITC returned $1,577,614,579. This amounts to an average credit, fully refundable, of $2,012 per household.

Often, RALs are accompanied by stored value card programs. These cards are usually free, but they are attended by transaction fees, even for customer service or balance inquiries.

This report will utilize IRS SPEC data from 2003 to 2006 to look at trends and impacts on the state. The data set is not static, and reports made from IRS SPEC data over the same period are likely to have slightly different findings. The IRS continually updates its SPEC data, as returns are amended on an ongoing basis.

Background on RALs in North Carolina

Refund Anticipation Loans draw down the impact of our nation's leading anti-poverty benefit, the Earned Income Tax Credit. Refund anticipation loans bear high interest rates, in the context of the short period of their term. Most loans last less than 10 days. For that period, finance charges are at least $40 and often far more. Many of the RALs bear other fees, usually for additional services required by some customers to gain access to their payment.

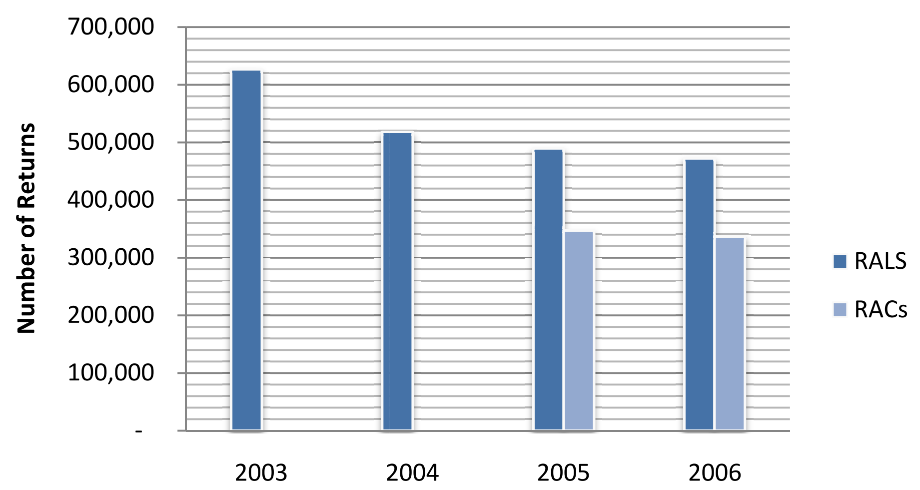
While it is hardly a good deal, the dynamics of living under cash flow constraints explain why so many low-income households opt to get a refund anticipation loan or a refund anticipation check. Consider the moment when a preparer poses the possibility of taking out a RAL. There are two criteria. First, do you want to pay for your tax preparation fees today? Second, do you want your refund in the next 24 hours, or sometime next week, at the earliest? If you are not going use direct deposit, the wait for a paper check could be as long as 6 to 8 weeks. This is a problem, considering how many older and low-income American are less reliant upon electronic banking.

For many low-income families, struggling to make ends meet, the answer is relatively obvious. It comes down to cash flow: it is better to not pay out-of-pocket for tax prep. Second, the sooner I can get money, the better. That explains the short-sighted behavior, seemingly at odds with rational self-interest, that motivates so many people to use RALs.

In North Carolina, use of RALs has declined somewhat. Tax preparers have introduced a complementary and far more benign product. That is the Refund Anticipation Check (RAC). RACs emerged with the 2005 filing season. They were popular from the start. While more filers use a RAL, RACs have gained a significant share of the market. In 2006, approximately 336,000 North Carolina filers opted for a Refund Anticipation Check (RAC).

The RAC is sensitive to "the out-of-pocket problem." Tax filers do not have to pay for their tax prep fees, which might run as high as $200, if they get a RAC. Instead, the fees are paid against the RAC. Since the tax preparer does not advance any funds to the client, and the consumer must come in to pick up their refund, the RAC is both safe for the preparer and convenient for the filer.

The next graph shows the use of RAL and RAC products over the period from 2003 to 2006.



Use of RALs declining as RACs emerge in North Carolina

It is good news to see that the use of RALs is generally trending downwards. That said, they remain very popular: almost half a million households have used one during 2005 or 2006, and more prior to that.

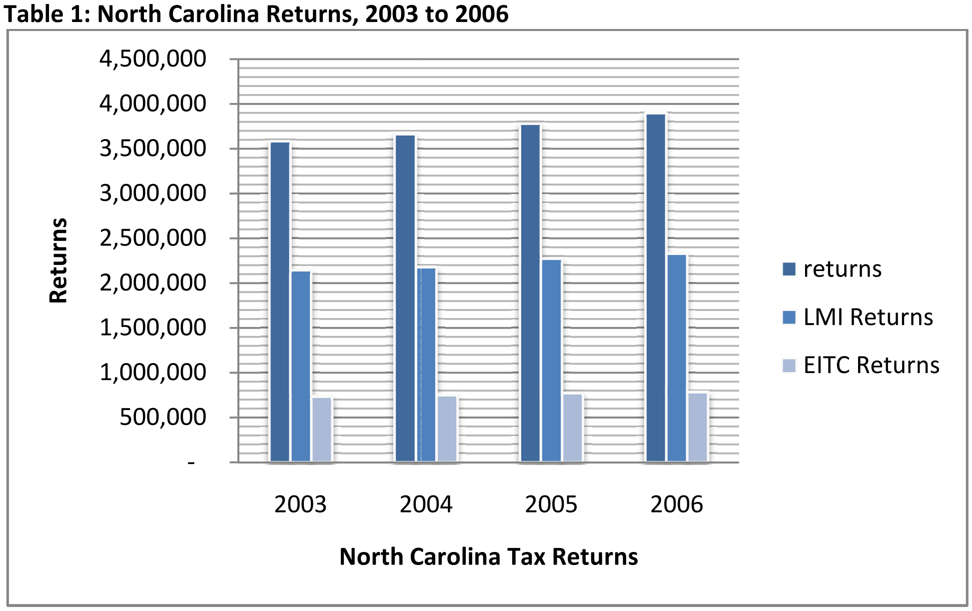
A Good Development: The Rise of the RAC

The RAC is probably responsible for much of the decrease in RAL usage. However, it appears that RACs are probably appealing to other consumers as well. RAC usage is highly correlated to RAL usage, on the level of zip codes. The statistical correlation is strongly positive - 66.9%. This means that for every additional percentage of point of RALs used in a zip code, about two-thirds of a percentage of all filers instead opt for a RAC.

RACs make sense because many consumers are also unbanked. Many RAL consumers must also apply for an account to deposit their return. They can get a temporary bank account, or in some cases, an electronic stored value card. The H&R Block Emerald Card is free, but it costs $1.95 for each transaction made on the card. Jackson Hewitt has a VISA card with its own fee schedule. It includes fees for balance inquires and for some transactions.

The next chart shows some general statistics on North Carolina's tax returns. It includes breakouts for returns filed, low-income returns (based upon household size), and EITC returns. We know that the general use of RALs has declined in 2005 and 2006, in part because of the Refund Anticipation Check (RAC).

Table 1: North Carolina Returns, 2003 to 2006



source: IRS SPEC

North Carolina's population is steadily growing. The number of returns filed reflects that growth. The share of low-income returns is holding steady, with each year fluctuating slightly above or below 60 percent. Although policy efforts have sought to increase EITC participation, the story remains the same for EITCs, too. Each year, between 20.5 and 20.1 percent of all households claimed the EITC.

Geographic Impacts

Consumers are most likely to use a RAL in Eastern North Carolina, the areas near Charlotte, and in Cherokee. All of these communities have higher percentages of minority residents. In Cherokee, the impetus may also stem from the presence of Harrah's Casino.

For this report, CRA-NC has prepared four maps. Each one shows a slightly different characteristic of the geographic dispersion of RALs or the EITC.

The first map depicts the percentage of RALs utilized among filers in various zip codes in North Carolina. The same story that will portray all of the maps about rates of RAL utilization is evidenced here. Filers in poor communities get more RALs.

Table 1: Where RALs are most prevalent, percentages

ZIP	Community	County	Percent RALs	Percent RACs	Total Returns	Total RALs	Poverty*
28362	Marietta	Robeson	42.72%	13.59%	103	44	25.0
28039	East Spencer	Rowan	41.79%	19.13%	481	201	21.2
28119	Morven	Anson	41.60%	10.44%	1,149	478	39.9
27867	Potecasi	Northampton	41.53%	9.32%	118	49	43.8
27890	Weldon	Halifax	38.80%	9.91%	1,080	419	40.7
27821	Edward	Beaufort	38.10%	8.93%	168	64	48.8
27823	Enfield	Halifax	37.48%	12.08%	3,311	1241	44.6
27849	Lewiston	Bertie	37.47%	12.53%	726	272	40.6
27831	Garysburg	Northampton	37.15%	12.66%	1,319	490	45.0
28007	Ansonville	Anson	36.56%	8.87%	372	136	27.0

Source: Census 2000, SF3. Percent in Poverty: Households under 150 percent of Poverty Line

Table 1 confirms impressions that RALs are coincident in communities where rates of poverty are very high. For the most part, this shows how RALs are particularly a problem in rural areas. They are tucked away in some of our states less frequented communities, out of sight from the same public scrutiny that might attend social issues that plague big cities.

Then again, parts of big cities have their own challenges from RALs. Some of the places with highest counts of RALs are in low-income neighborhoods in our big cities. It affects all of North Carolina's big cities: Charlotte, Raleigh, Greensboro, Winston-Salem, and Fayetteville. The next table shows the zip codes where the most RALs were originated in 2006.

Table 2: Zip Codes with the Most RALs, 2006

	Geography				LMI			EITC	
ZIP	City	County	RALs	RALs	RACs	Returns	RALs	RACs	EITCs
27834	Greenville	Pitt	4,502	4,236	1,894	13,857	3,634	1,251	6,742
28208	Charlotte	Mecklenburg	4,441	4,199	2,032	11,005	3,582	1,464	6,499
27893	Wilson	Wilson	4,218	3,902	1,357	11,175	3,338	891	5,716
27610	Raleigh	Wake	3,983	3,523	2,755	15,971	2,782	1,716	7,112
27105	Winston-Salem	Forsyth	3,793	3,544	1,966	12,020	2,842	1,316	5,900
28215	Charlotte	Mecklenburg	3,725	3,240	2,284	14,156	2,501	1,454	6,077
27406	Greensboro	Guilford	3,696	3,299	2,152	14,824	2,586	1,286	6,002
27405	Greensboro	Guilford	3,677	3,334	2,059	12,908	2,595	1,308	5,849
28216	Charlotte	Mecklenburg	3,593	3,131	2,039	12,111	2,554	1,306	5,516
28358	Lumberton	Robeson	3,448	3,194	979	9,128	2,709	700	4,649

Source: IRS SPEC

So in spite of the high percentage concentrations that seem to plague rural areas, Table 2 demonstrates that RALs are still something that matters in urban areas. Of note, examine how many EITC recipients are getting either a RAL with their return. In some of these zip codes, more than half of EITC recipients spend a part of their refund on a high-cost RAL. Again, this drains an otherwise well-intended benefit.

Impacts on the Working Poor

RALs (and RACs) are dependent upon the use of the EITC as an anti-poverty program. RALs and RACs are utilized by low-income households. More often than not, these families rely upon one asset for income – their wages. The EITC rewards their work with a refundable credit. Withholding allows families to designate their tax liability on wages throughout the year. Fewer low-income families itemize, opting instead for the standard deduction. Taxes are relatively straightforward.

The driving force on high dollar refunds is the EITC. In 2006, 783,956 households claimed an EITC, bringing pocket books in the state a total of $1.577 billion. On average, households that claimed the EITC got a credit of $2012.

RALs coincide with poverty. This study called upon Census data (Summary File 3) that shows the percentage of households living at 150 percent or less of the federally defined poverty level. These numbers control for family size. The dollar amounts are the same regardless of MSA income. In 2000, the poverty rate for a household with four people was $17,000 (Department of Health and Human Services, 2000). Thus, this analysis captures households with for people with incomes below $25,500.

The data reveals a very high correlation with low income (150 percent of poverty). For every additional percentage point of households living at or below 150 percent of the poverty level, an additional 0.67 percent of filers applied for RAL. (Correlation coefficient equals 0.6658)

Race and Refund Anticipation Loans

Many of the communities with the highest rates of RAL usage are those with more people of color. The statistical relationship is fairly strong. For each additional percentage point of African-American residents in the population of a zip code, an additional 0.71 percentage point of filers used a RAL. (correlation coefficient equals 0.71) When accounting for minority status, the relationship is even higher – a correlation coefficient of 0.74).

In all, more than 175,000 RALs were originated in majority minority zip codes in North Carolina. This means that RALs are highly concentrated in majority minority zip codes. Those zip codes only account for about 16 percent the population in North Carolina, but they are the location for 38.8 of all RALs.

There are some worrisome marketing efforts under way at some of the corporate tax preparation chains. At Jackson Hewitt, the “tax experts” on its web site are all white. The consumers are people of color. The spokespersons (Magic Johnson, Tyra Banks) at Jackson Hewitt are also African-American.

At Liberty Tax Service, all but one screen on its web site feature people of color. That screen revolves in a series, and most of the people in that series are still people of color. The franchisee page features a white couple. Likewise, the featured “Liberty Tax” costumed person is an African-American. While this is a staff person, it is hardly a job that confers the prestige of an accountant.

H&R Block is the exception to the industry standard. There is a mix of minority and Caucasian persons throughout the site. The asset-focused services available through Block Bank (banking, investments) include minorities on most screens.

The EITC

The EITC is the light at the end of the tunnel for low-income families working to make ends meet. North Carolina passed a state EITC last year. Some legislators hope to find a way to increase the size of the EITC by next year. Currently, it offers a return to state filers based upon the amount of their federal EITC. The state credit is 3.5 percent of the federal EITC. It represents a seamless stimulus for families.

Areas Receiving the Most Federal EITC Dollars, 2006

Zip Code	City	EITC Dollars	EITC Recipients
27834	Greenville	$15,264,594	6,742
27610	Raleigh	$15,070,884	7,112
28208	Charlotte	$15,051,511	6,499
28215	Charlotte	$13,090,289	6,077
27105	Winston-Salem	$12,925,969	5,900
27893	Wilson	$12,873,750	5,716
28314	Fayetteville	$12,564,553	6,058
27405	Greensboro	$12,350,222	5,849
27406	Greensboro	$12,335,197	6,002
28216	Charlotte	$11,914,367	5,516

Source: IRS SPEC

Policy Looking forward

More can be done. North Carolina is not addressing take up rates of the EITC. In fact, the share of low-income filers getting the EITC has actually declined since 2003, albeit by a very small amount. The fact remains that North Carolinas leave money on the table, and continue to do so, in spite of the obvious advantages of utilizing the credit.

Cease the debt indicator. Federal policy could quickly impact the use of RALs. Before preparers write a refund anticipation loan, they check the federal government to make sure that there are no outstanding tax liens against the filer. This reduces the risk for the private company. If the government ceased to provide the debt indicator service, very few tax preparers would provide RALs. They would be able to offer the RAC, however. This is an outcome that meets the needs of consumers to have a prompt refund without paying cash out of their pockets.

There are privacy concerns with the debt indicator. The filer’s tax information, having been commented upon by the government, becomes the property of the private corporation that submitted the debt indicator request. That information is no longer subject to the control of the filer. Instead, it is governed only by the data policies of the company. In most cases, the information is saleable and transferable.

Marketing of VITA sites needs shoring up. VITA sites are a great resource. Many go underutilized. The problem may be in marketing. VITA sites, right now, are not part of the solution for maximizing the EITC.

The good news is that more people are using VITA sites. Total returns filed my VITA sites in North Carolina almost doubled from 2003 to 2006. The gains have been made among low-income families, but not among those that would qualify for the EITC. In 2006, only about 10 percent of VITA returns got the EITC. This could be an issue of marketing. Perhaps more outreach needs to be done through pathways associated with working. The Employment Security Commission might have a good contact list of people. As well, county governments employ a large number of lower-income workers.

Do not provide TARP funds for RAL providers. Santa Barbara Bank & Trust is one of the five banks that provide the funds for individual and corporate tax preparer's RALs. It is a subsidiary of Pacific Capital Bancorp. Santa Barbara received $182 million in TARP funds. The company's income stream is largely dependent upon its highly profitable RAL business.

There are several reasons not to put taxpayer money into RALs. One reason is fraud. While it is certainly not true that all RALs are fraudulent, it is evident that RALs do often become the place for fraudulent schemes. Going back to Pacific Capital, in 2007, they recognized loan losses on their RAL portfolio of $116 million. Many of those losses stem from fraud.

Second, PCBC depends far too much on RALs for its business. It is hard to give money to a bank to make loans and to imagine that it won't be for RALs. In 2006 and 2007, the portions of PCBC's business that were outside of its RALs and refund transfer businesses lost money. This is a $7.3 billion bank, but it makes almost $6 billion per year in RAL loans. RALs and refund transfers, even after loan losses, still account for more than $100 million in net income (Pacific Capital Bancorp, 2008).

Refund Anticipation Checks represent a good alternative for RAL consumers. They are not without utility. Many consumers who go to private tax preparers need not just a return, but also some kind of deposit account in order to accept their refund. RACs can be made in a check or through a stored value card. Jackson Hewitt uses a VISA card, while H&R Block has a MasterCard. In either event, it represents a realistic means of meeting the needs of the unbanked, without imposing the additional costs of the RAL. Moreover, customers who get RACs can still use their refund to pay for their tax prep. The consumer's tax prep fees are deducted from the RAC, which usually arrives in less than two weeks. For consumers who do not have $200 in walking around money, that feature makes a big difference.

RALs continue to be an outsized problem among rural communities and in neighborhoods of color. The use of RALs is concentrated in these zip codes. Poor communities are also hurt. The impact is one that thwarts our government's intentions to reduce poverty. It is a loophole that depends upon the debt indicator.

Works Cited

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