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Income vs. Race Effects in Refund Anticipation Loan Utilization

Richard J. Smith, Ph.D, MSW, MFA

Abstract This purpose of this paper is to illustrate how data can target outreach for social and economic justice by testing for an association between refund anticipation loan (RAL) utilization and a Zip code's racial and income characteristics. RALs are rapid tax refunds marketed by tax preparers.

Keywords Refund Anticipation Loans, Tax Policy, Poverty, Consumer Protection, Social Justice

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Introduction

The Children's Defense Fund (2007) and Karger (2005) have recently highlighted the cost of RALs to children and low income families. Policy makers initially raised this issue when US Representative Joseph Kennedy called a hearing on RALs, which had fees of \$30-\$100, which if translated into effective annual percentage interest rates (APR) "would make a loan shark blush" (United States House of Representatives, 1995). The National Consumer Law Institute (NCLI) estimated that the effective APR ranged from 97.4% to 2000% (Wu & Fox, 2003). Stearns et. al. (2006) highlighted the importance of financial education when they found that 97% of low income subjects retracted their decision to buy an RAL after hearing the interest rate.

As an emerging solution, the Internal Revenue Service (IRS) and partners provide free electronic tax preparation at Volunteer Income Tax

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Assistance (VITA) sites. Families save filing fees and still get a timely refund that might include an Earned Income Tax Credit (EITC). Consumer groups recommend 1) banning the use of RALs for the EITC, 2) stricter regulation, 3) free electronic filing directly with the IRS and deferred payment of tax preparation services (Wu, C. C. et. al., 2007).

Who buys RALs? Brookings found that filers in low income, high immigrant Zip codes were more likely to see a paid tax preparer, but were less likely to ask for a RAL (Berube, 2005). NCLI also found that half of RAL users were poor families who paid \$1.14 billion in fees associated with RALs. (Wu & Fox, 2005). In December 2005, a NCLC telephone poll (N=2000) determined that while only 17% of white respondents bought a RAL, 21% of Latinos and 28% of African-Americans reported taking a RAL. Authors compare this to an unpublished study by Brookings that found that the percent of EITC claiming taxpayers who take an RAL increases 1.6% for every 10% increase in the percent African Americans in a Zip code (C. C. Wu & Fox, 2005).

Although the preceding literature data may be daunting, social work research shows that organizing around taxpayer education works. Brooks et. al. (2006) conducted a mixed method program evaluation of ACORN's VITA outreach in Hispanic and African American low income neighborhoods. They found in a random digit dialing phone survey (N=1,063) that canvassed areas had a greater proportion of persons filing for free at VITA sites than those in the comparison group. Fisher et. al. (2007) documented tactics waged nationally by the Association of Community Organizations for Reform Now (ACORN) that were effective in getting H&R Block to reduce RAL fees.

In order to target outreach, one might need to know the variation in RAL utilization across years, across states or within the same year in the same state across Zip codes. Also, is there an association between RAL utilization and race, percent poverty status, percent foreign born or percent linguistically isolated?

Method

To answer these questions, I used RAL data (2000) from the IRS available at Brookings' website: <http://www.brookings.edu/urban/eitc/>. At the national level, I fit a variance components model of the number of RAL

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filers divided by the number of returns in Zip codes in states (N1=38,745, N2=51). Next, I estimated a regression model for California Zip codes (N=2490) to determine if consumer utilization of RAL in 2002 could be explained by race, percent poverty status, percent foreign born or percent linguistically isolated (Long Form Census, 2000).

Results

Most of the variance was explained at the Zip code level ($\theta=.31$). Year effects explained slightly more variance than state effects (.06 vs. .03). Zip codes within states within the same year had a modest interclass correlation of 22%. Zip codes in California with a high percentage of Hispanics and poor people appeared to also be those that had a high percentage of RAL utilization. Conversely, Zip codes with high white and high foreign born populations were also those with low RAL utilization.

These variance components suggest that RAL use is changing and targeting low income and minority Zip codes would improve outreach. Social work educators can use the following tools to enhance advocacy. For example, Brookings has an interactive EITC database that can allow you to target Zip codes that can 1) increase utilization of the EITC and 2) identify areas where taxpayers can be directed towards IRS VITA sites or free filing in general. Students may use geographic software to create outreach management tools. Finally, the IRS offers multilingual brochures about tax credits and grants to support prospective VITA sites.

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Appendix A: Presentation coversheet for the Annual Program Meeting of the Council on Social Work Education in San Francisco, CA, October 29th, 2007

Learning Objectives

By the end of this session social work educators will be able to

- identify the costs and benefits of refund anticipation loans for low and moderate income families in multicultural areas,
- identify ways to the tax system provides income to low income families,
- identify public outreach strategies to for low and moderate income families in multicultural areas for tax incentives and direct them to Internal Revenue Service Volunteer Income Tax Assistance (VITA) free tax preparation ,
- use data from IRS, the US Census Bureau and the Brookings Institution and geographic information systems technology to target Zip codes for outreach.

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Biographical Sketch

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