

“Magic” Money a Mere Illusion:

Refund Anticipation Loans & the Earned Income Tax Credit in West Virginia

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REFUND ANTICIPATION LOANS & THE EARNED INCOME TAX CREDIT IN WEST VIRGINIA

Introduction

Working West Virginians with modest incomes lost nearly \$13 million of their 2006 federal income tax refunds to tax preparers who promised them “fast cash.”

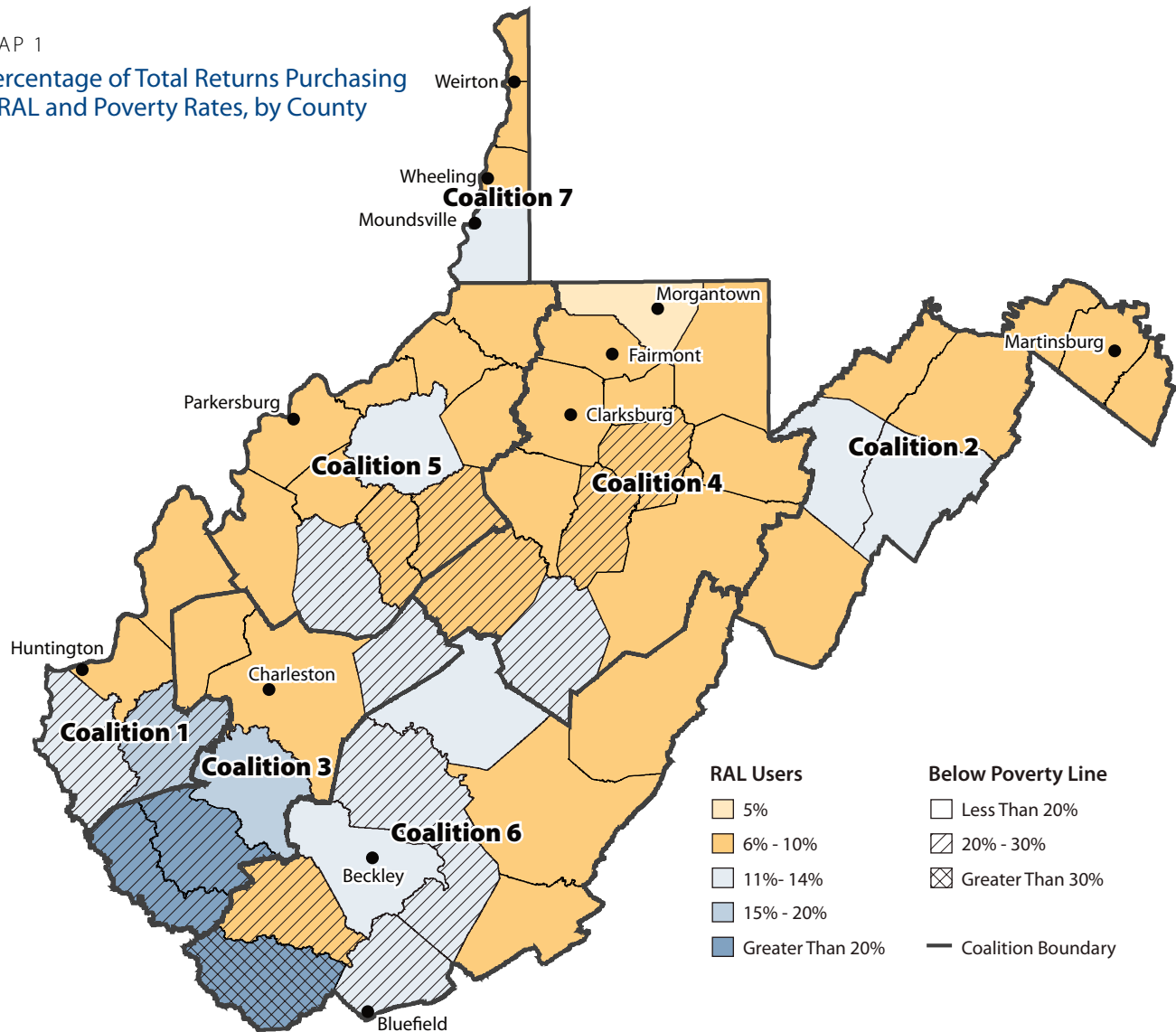
Refund anticipation loans (RALs) are short-term loans that provide a credit or cash advance to qualified individuals based upon their expected tax refund, while charging high interest rates on the funds. Despite West Virginia’s strong laws prohibiting or limiting many forms of predatory lending practices, including payday loans,¹ RALs are utilized frequently during tax season. In 2007, nearly 77,000 West Virginia residents, of whom 59 percent received the Earned Income Tax Credit (EITC), purchased a RAL.

What Would \$12.66 Million Buy for West Virginia’s Working Families?

- One month’s food supplies for 24,630 families
- One month’s rent for 22,770 families
- One month’s child care costs for 26,049 families

MAP 1

Percentage of Total Returns Purchasing a RAL and Poverty Rates, by County



Tax preparation companies present their customers with this option as an alternative to the IRS direct deposit or paper check, and market these loans with the promise of “fast cash,” as users typically receive money in one to two days. Jackson Hewitt’s Money Now loan can actually be received in one hour, faster than some prescriptions are filled.

According to the Center for Responsible Lending, RALs are “short-term cash advances against a customer’s anticipated income tax refund.”²

H&R Block advertised its RAL with the slogan, “Fast money for less.” The tagline read, “Save on a Refund Anticipation Loan when you put it on an H&R Block Emerald Prepaid MasterCard.”³ As Table 1 demonstrates, these so-called savings are negligible compared to the fees charged. Jackson Hewitt’s commercials in 2009 featured former NBA superstar, Magic Johnson, playing basketball with young children. His words perfectly highlight the marketing strategy taken by these tax preparation companies. “Sooner or later we all need help. If you need cash quickly, Jackson Hewitt has the Money Now loan. It’s fast. It’s simple. It’s money like magic.”⁴ Such advertising fails to mention how much this magic costs the borrower.

These “fast cash” loans clearly are marketed to those who need money quickly during tax season. However, they hold special appeal to cash-poor individuals without personal bank accounts who cannot take advantage of the IRS’ direct deposit service, which normally gives taxpayers access to their refund in a matter of days. The alternate option - receipt of a paper check - takes two to three weeks if the individual files electronically or six to eight weeks if he or she files a paper return. For those individuals without bank accounts dealing with a financial emergency, whether medical debt or avoiding an eviction notice, the fast cash promise of a RAL presents itself as the obvious choice. The tax preparation company either deposits the loan into a temporary account set up with a partner financial institution or issues a paper check. Those West Virginians who do not have a bank account⁵ or access to other forms of credit through the financial mainstream can turn to RALs if money is needed in a hurry.

As to why West Virginians, especially low- to moderate-income working families, continue to use RALs at such a high rate, the answer remains purely speculative in the absence of data. It may be that individuals decide that the costs associated with evictions, utility turnoffs, medical emergencies, and other unforeseen emergencies are greater than the lost fees associated with a RAL. Others may simply be lured by the promise of instant money. Until there are better data on the usage of RALs, an analysis of the issue can only examine costs and some general demographic traits of the majority of RAL purchasers.

TABLE 1

Estimate of Cost in 2008 for a Refund Anticipation Loan

Sample Loan (\$)	Fixed Fees		Variable Fees	Delivery Fees		Amount of RAL Received (via Emerald Card) (\$)	Amount of RAL Received (via Bank Check) (\$)
	Tax Preparation Fee (\$)*	Refund Account Fee (\$)		Option A	Option B		
			Finance Charge (\$)	Emerald Card (\$)	Bank Check (\$)		
1,000	165.00	29.95	10.73	40.68	60.68	753.64	733.64
1,500	165.00	29.95	16.09	46.04	66.04	1,242.92	1,222.92
2,000	165.00	29.95	21.46	51.41	71.41	1,732.18	1,712.18
3,000	165.00	29.95	32.19	62.14	82.14	2,710.72	2,690.72
4,000	165.00	29.95	42.92	72.87	92.87	3,689.26	3,669.26

Source: H&R Block. www.hrblock.com/taxes/pdf/2008_RAL_pricing_tool.pdf

* Using fee quoted in the source.

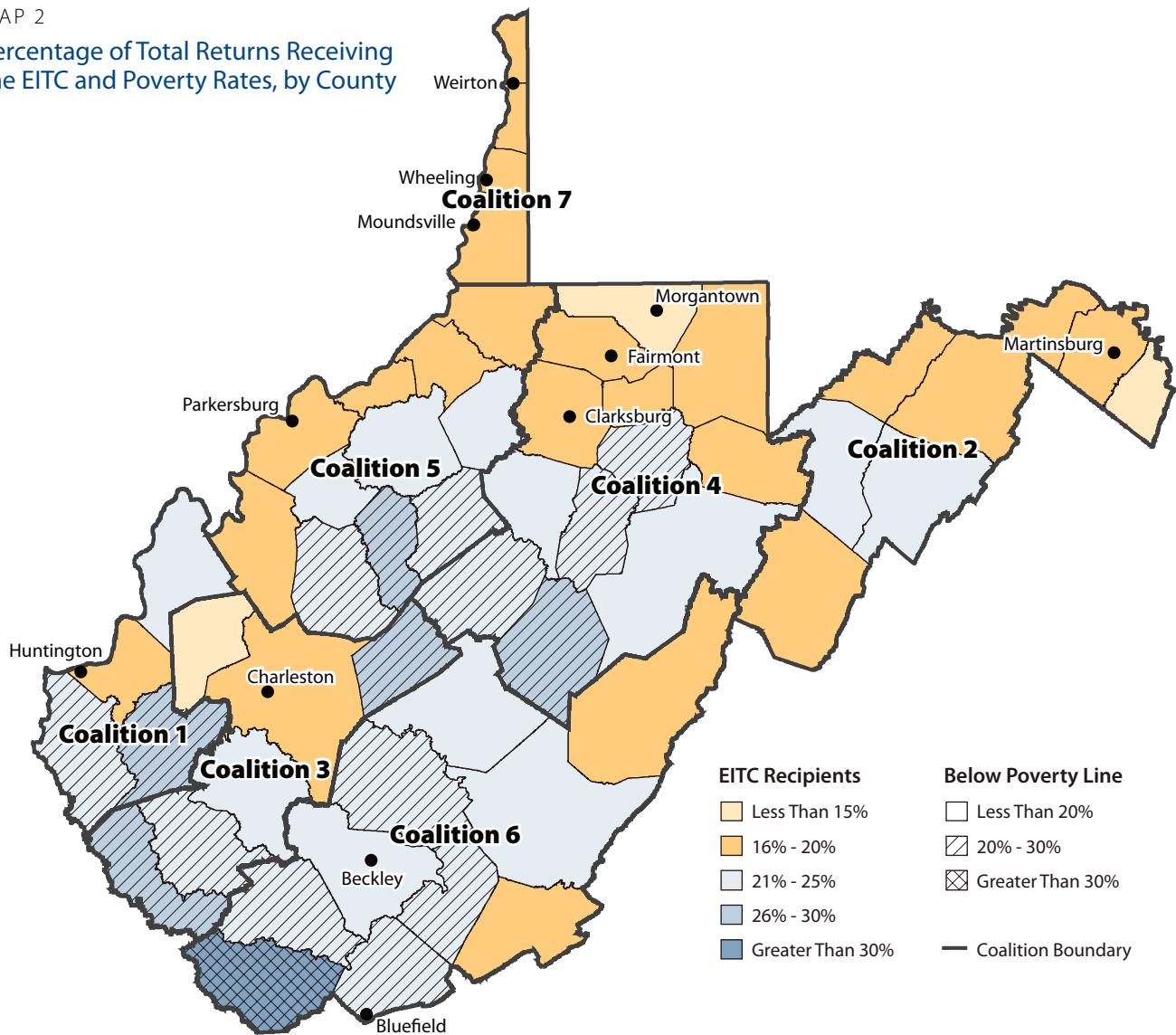
The Cost of Purchasing a RAL

Although borrowers pay nothing out of pocket on the day they have their taxes prepared, they end up having high fees deducted from the loan amount. Table 1 illustrates this point using data from H&R Block, the largest tax preparation company in the country. If an individual took out a loan for \$2,000, he or she would receive only \$1,700 at the end of the day. Purchasing a RAL costs nearly \$300, not including the additional fees the borrower encounters once the loan is received, such as the \$1.95 transaction fee accrued each time he or she uses an ATM.⁶ According to the Center for Responsible Lending, the effective interest rate for these very short-term loans ranges from about 40% to over 700% APR.⁷

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MAP 2

Percentage of Total Returns Receiving the EITC and Poverty Rates, by County



The Disproportionate Use of RALs by EITC Recipients

Although EITC recipients make up only 20 percent of West Virginia’s taxpayers, they account for nearly 60 percent of RAL purchases in the state. In 2007, three out of ten EITC recipients chose to buy a RAL rather than wait for their refund via direct deposit or paper check. This high rate of use is problematic, because it redirects a significant portion of federal EITC funds from their intended purpose. This tax credit, aimed at low- to moderate-income working individuals and families, reduces the amount that a filer owes in taxes and provides a refund to the taxpayer if the credit is larger than what he or she owed. The income support received by this wage supplement helps West Virginia’s families make ends meet. Since the refund money typically is spent quickly and locally on goods and services,

such as home repair, groceries or child-care, the EITC also brings important revenue into communities. The EITC brought \$261,351,817 into West Virginia in 2007, with an average refund of \$1,800.⁸

Assuming that the average EITC recipient who buys a RAL loses approximately \$280 from his or her actual refund in fees and services (see Table 1), low- to moderate-income working West Virginians were deprived of \$12.66 million that had been intended to reduce poverty by helping them make ends meet. Instead, nearly 5 percent of the federal EITC funds coming into the state went toward paying fees associated with tax preparation and the purchase of RALs.

The EITC's Biggest Losers from RALs

An examination of the seven counties in West Virginia with the highest prevalence of EITC recipients purchasing RALs paints a grim picture (Table 2). Five of the seven counties had more than 20 percent of their population under the federal poverty threshold in 2007, ranging from 21.8 percent in Mercer to 34.7 percent in McDowell. An approximation can be calculated of how much money in each county is redirected from its intended purpose when EITC recipients utilize RALs rather than waiting for their refunds to arrive in the normal time.

Five of the counties listed in Table 2 (Logan, Mingo, Boone, McDowell, Raleigh) saw more than 6 percent of their EITC dollars go to tax preparation companies instead of toward helping working families make ends meet. Throughout West Virginia, 4.85 percent (\$12.66 million) of EITC refunds were redirected to buying RALs. Appendix 1 ranks the counties by an approximation of the EITC dollars spent on the purchase of these loans in 2007. Based on these figures, EITC recipients in the counties making up the greater Charleston area (Kanawha, Boone, Lincoln, Putnam, Clay) spent about \$2.31 million on the purchase of RALs, while those in the greater Huntington area (Wayne, Cabell, Mason) spent about \$1.15 million.

MAP 3

Percentage of EITC Recipients Purchasing a RAL and Poverty Rates, by County

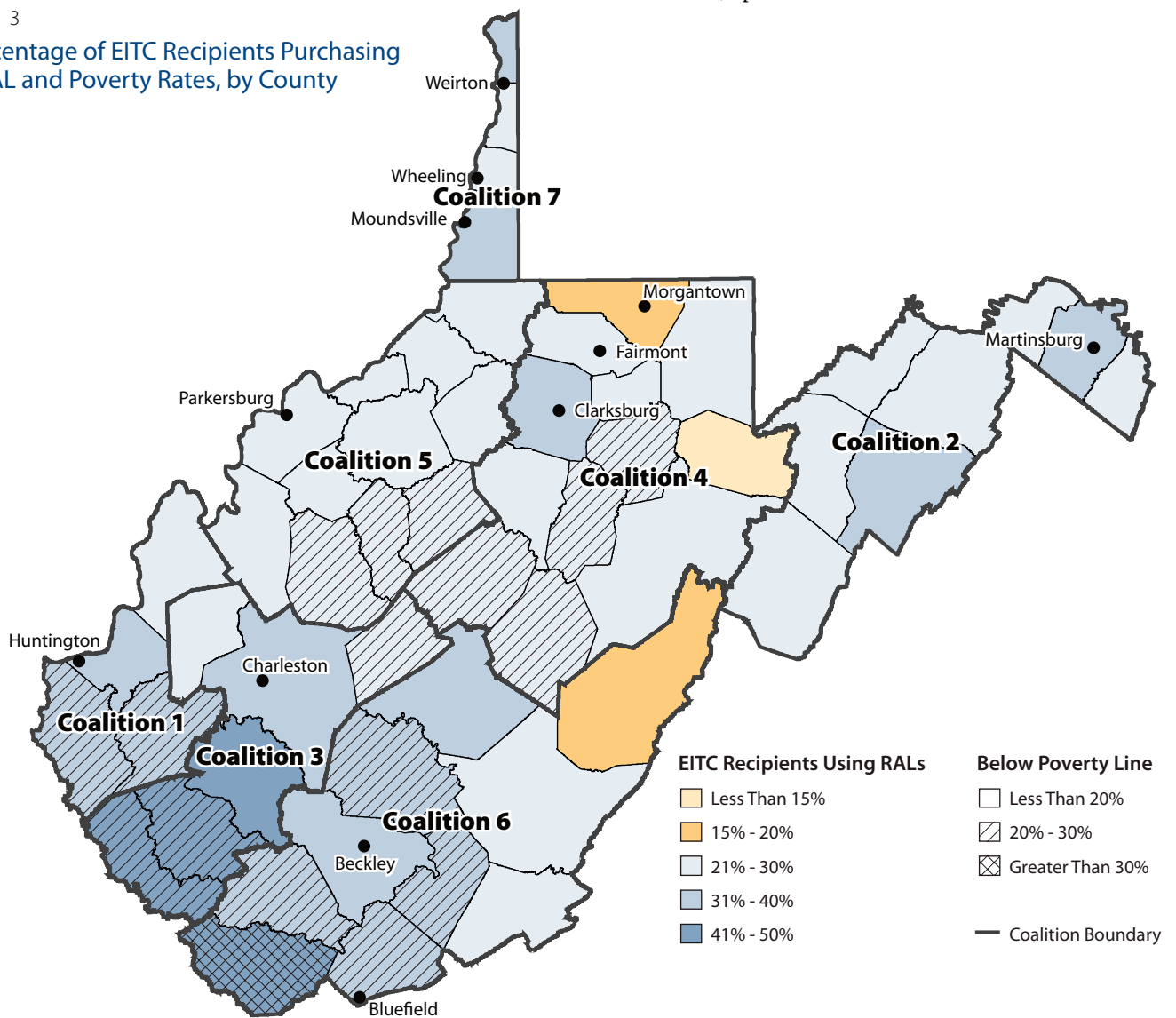


TABLE 2

Counties with the Highest Prevalence of EITC Recipients Using RALs, 2007

County	EITC Returns	Percentage of EITC Recipients Who Purchased RALs	Number of EITC Recipients Who Purchased RALs	Total EITC Dollars Received in County (\$)	EITC Dollars Spent on Purchase of RALs (\$)	Percentage of EITC Dollars Spent on RALs in County*
Logan*	3,044	46.62%	1,419	5,689,606	397,320	6.98%
McDowell*	2,199	44.52%	979	4,400,508	274,120	6.23%
Mingo*	2,411	43.43%	1,047	4,578,225	293,160	6.40%
Boone	1,858	41.66%	774	3,398,421	216,720	6.38%
Lincoln*	2,006	39.88%	800	3,794,117	224,000	5.90%
Raleigh	6,462	39.46%	2,550	11,905,903	714,000	6.00%
Mercer*	5,768	38.94%	246	11,085,422	628,880	5.67%

Source: The Brookings Institution's EITC Interactive. 2006 tax year data. Calculations by West Virginia Center on Budget and Policy.

* Counties with over 20 percent of the population under the federal poverty threshold in 2007. Data from the U.S. Census Bureau, West Virginia Quick Facts.

Recommendations

A number of options could be pursued in order to reduce the number of Refund Anticipation Loans purchased by West Virginians, especially those receiving the Earned Income Tax Credit.

1) The statewide EITC Coalition could develop an outreach campaign to educate the public about the high cost of utilizing RALs and about the low- or no-cost alternatives.

- The Attorney General's office could be a partner in this endeavor.
 - A press release or Consumer Advisory Statement could be released just prior to tax season about the pitfalls of RALs, as has been done in Iowa, Illinois, and other states.
 - Include a discussion of RALs on the Attorney General's website year-round.
 - Create a brochure to be distributed in conjunction with the state-level EITC Coalition and other partner groups.

Suggested Resources: The National Consumer Law Center (http://www.consumerlaw.org/initiatives/refund_anticipation/); California Reinvestment Coalition (<http://www.calreinvest.org/predatory-lending/refund-anticipation-loans>); United Way of the Midlands (www.uway.org/public/files/docs/Refund_Anticipation_Loans.pdf).

2) The statewide EITC Coalition could increase the number and size of free tax preparation sites (e.g. Volunteer Income Tax Assistance, Tax Counseling for the Elderly) throughout the state, particularly targeting those ZIP codes with the highest RAL usage (see Appendix 2). The Coalition could aim to have at least one VITA site in every county and could seek out additional sources of volunteers.

3) The statewide EITC Coalition could promote and expand existing partnerships with local banks and credit unions in order to encourage more people at tax preparation sites to open free or low-cost accounts that will benefit them long after tax season ends.

Some examples of successful partnerships in other states:

- In Illinois, the Center for Economic Progress (<http://www.centerforprogress.org/>) has over 30 community tax sites where people can have their taxes done for free and tax filers without bank accounts can open a savings or checking account through one of the Center's banking partners.
 - Some of the Northern Kentucky University Asset Building Coalition (<http://access.nku.edu/litc/>) tax sites can open a free bank account for filers who do not currently have one.
 - The Denver Asset Building Coalition (<http://www.denverabc.org/sites.htm>) helps low- to moderate-income people open free checking accounts at its Tax SuperSites.
- 4)** Non-profit organizations and/or local banks should create alternative options for refund loans.

Some successful models in other parts of the country:

- AccountAbility Minnesota (<http://www.accountabilitymn.org>), a non-profit organization established in 1971 by accounting professionals, offers low-cost Express Refund Loans to some qualified individuals. These loans only cost \$30, and the borrower has a free savings account opened for him or her at a local credit union partner.
- Alternatives Federal Credit Union (<http://www.alternatives.org/>) in Ithaca, NY, offers low-cost Refund Express Loans for a \$20 fee plus any interest that accrues over 2 weeks at 12.95% (ranging from \$5-\$30, depending on the size of the refund). The Credit Union, which offers free tax preparation, sets up a Line of Credit when the IRS accepts the return. Once the borrower's federal refund is directly deposited into the Credit Union savings account, it is transferred to pay off the Line of Credit.

Appendices

APPENDIX 1

Rankings of EITC Dollars Spent on Purchasing RALs, by County

County	EITC Returns	Percentage of EITC Recipients Who Purchased RALs	Number of EITC Recipients Who Purchased RALs	Total EITC Dollars Received in County (\$)	EITC Dollars Spent on Purchase of RALs (\$)	Percentage of EITC Dollars Spent on RALs in County*
Kanawha	15,907	34.37%	5,468	28,291,366	1,531,040	5.41%
Raleigh	6,462	39.46%	2,550	11,905,903	714,000	6.00%
Cabell	7,586	30.89%	2,343	12,962,283	656,040	5.06%
Mercer	5,768	38.94%	2,246	11,085,422	628,880	5.67%
Berkeley	7,003	30.97%	2,169	12,316,375	607,320	4.93%
Wood	7,086	29.06%	2,059	12,945,719	576,520	4.45%
Harrison	5,805	30.20%	1,753	10,492,518	490,840	4.68%
Fayette	4,221	34.26%	1,446	7,766,918	404,880	5.21%
Logan	3,044	46.62%	1,419	5,689,606	397,320	6.98%
Wayne	3,556	33.24%	1,182	6,628,559	330,960	4.99%
Marion	4,322	24.36%	1,053	7,491,715	294,840	3.94%
Mingo	2,411	43.43%	1,047	4,578,225	293,160	6.40%
McDowell	2,199	44.52%	979	4,400,508	274,120	6.23%
Monongalia	4,837	19.54%	945	7,836,446	264,600	3.38%
Putnam	3,242	29.12%	944	5,787,030	264,320	4.57%
Ohio	3,412	27.46%	937	5,892,161	262,360	4.45%
Marshall	2,736	33.08%	905	5,059,060	253,400	5.01%
Lincoln	2,006	39.88%	800	3,794,117	224,000	5.90%
Jefferson	2,840	27.71%	787	4,925,168	220,360	4.47%
Boone	1,858	41.66%	774	3,398,421	216,720	6.38%
Greenbrier	2,981	25.49%	760	5,258,417	212,800	4.05%
Hancock	2,329	31.73%	739	4,030,236	206,920	5.13%
Randolph	2,661	27.70%	737	4,629,820	206,360	4.46%
Nicholas	2,246	32.46%	729	3,978,852	204,120	5.13%
Wyoming	2,037	35.30%	719	3,604,674	201,320	5.58%
Jackson	2,196	28.28%	621	4,034,195	173,880	4.31%
Mineral	2,247	26.88%	604	4,054,335	169,120	4.17%
Preston	2,557	23.07%	590	4,454,779	165,200	3.71%
Mason	1,968	29.47%	580	3,628,028	162,400	4.48%
Brooke	1,770	29.21%	517	2,995,062	144,760	4.83%
Upshur	2,069	24.55%	508	3,848,291	142,240	3.70%
Hampshire	1,813	27.08%	491	3,230,062	137,480	4.26%
Lewis	1,494	28.92%	432	2,637,602	120,960	4.59%
Hardy	1,196	35.95%	430	2,256,515	120,400	5.34%
Wetzel	1,490	25.84%	385	2,846,046	107,800	3.79%
Summers	1,106	32.64%	361	2,029,060	101,080	4.98%
Roane	1,226	28.55%	350	2,238,208	98,000	4.38%

Rankings of EITC Dollars Spent on Purchasing RALs, by County

County	EITC Returns	Percentage of EITC Recipients Who Purchased RALs	Number of EITC Recipients Who Purchased RALs	Total EITC Dollars Received in County (\$)	EITC Dollars Spent on Purchase of RALs (\$)	Percentage of EITC Dollars Spent on RALs in County*
Taylor	1,356	24.34%	330	2,467,021	92,400	3.75%
Grant	1,058	29.87%	316	1,880,119	88,480	4.71%
Monroe	1,019	29.34%	299	1,809,790	83,720	4.63%
Braxton	1,169	25.15%	294	2,149,970	82,320	3.83%
Barbour	1,417	20.54%	291	2,562,143	81,480	3.18%
Morgan	1,212	23.51%	285	2,067,457	79,800	3.86%
Clay	985	28.22%	278	1,901,082	77,840	4.09%
Ritchie	891	27.72%	247	1,639,438	69,160	4.22%
Tyler	690	28.26%	195	1,341,816	54,600	4.07%
Webster	862	21.81%	188	1,549,791	52,640	3.40%
Pendleton	584	29.62%	173	1,048,077	48,440	4.62%
Doddridge	672	24.70%	166	1,240,074	46,480	3.75%
Calhoun	661	24.05%	159	1,145,983	44,520	3.88%
Pleasants	584	27.05%	158	1,056,180	44,240	4.19%
Wirt	615	23.41%	144	1,181,417	40,320	3.41%
Gilmer	583	24.36%	142	1,047,366	39,760	3.80%
Pocahontas	758	15.17%	115	1,257,195	32,200	2.56%
Tucker	612	14.22%	87	1,005,196	24,360	2.42%
All Counties	145,415	35.30%	45,226	261,351,817	12,663,280	4.85%

Source: The Brookings Institution. 2006 tax year data from the Internal Revenue Service.
<http://www.brookings.edu/projects/EITC.aspx>

* Calculations by the West Virginia Center on Budget and Policy.

Percentage of EITC Recipients Using RALs in Regional Coalitions, by Zip Code

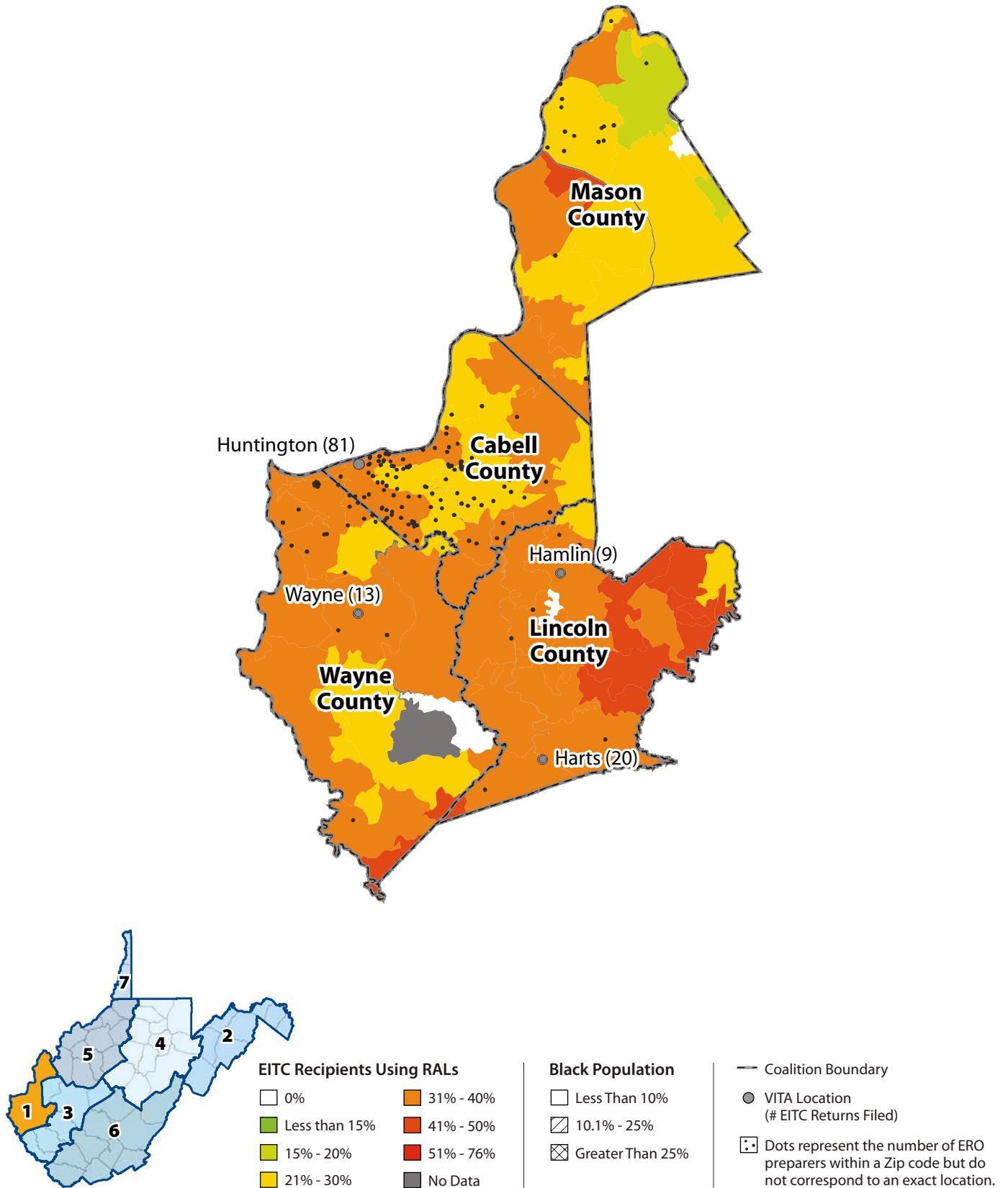
A Guide to the Coalition Maps

For the ease of understanding the data presented in these seven maps, the following guide should be read. All references contained in the guide below can be found on the map for EITC Coalition 6: Southern WV.

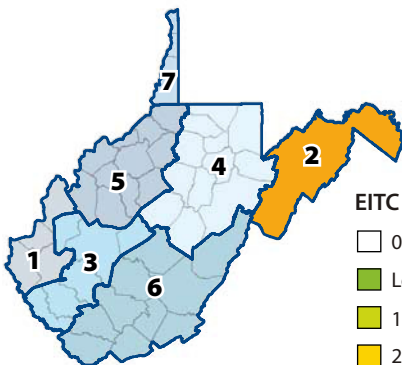
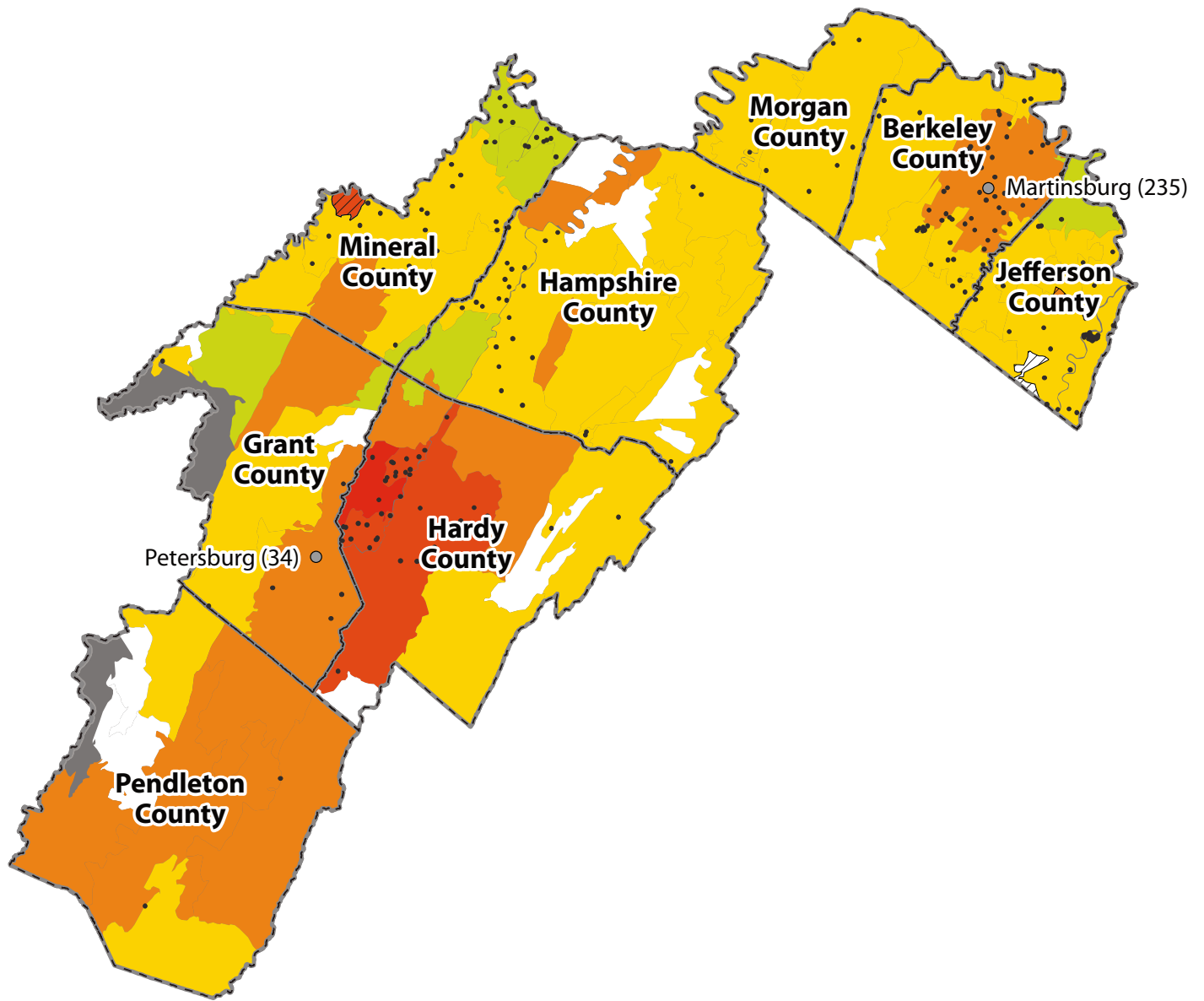
Each map displays four pieces of information:

- 1) The percentage of EITC recipients using RALs** by Zip code, which provides a richer picture of the differences within each county.
 - a.** Some counties, such as McDowell, have enough variance between Zip codes that it is easy to identify individual Zip codes.
 - b.** In some instances, adjacent Zip codes have the same percentage and therefore appear as one large block of color (e.g. Monroe County). However, by zooming in for more detail, you can see the light gray outline of each individual Zip code.
 - c.** Remember that overall in West Virginia, three out of ten EITC recipients purchased a RAL in 2007. The areas of the map shaded in orange and red hues all indicate higher than average RAL usage by EITC recipients.
 - d.** Areas of dark gray indicate that no data was available for that Zip code from the Brookings Institution's analysis of Internal Revenue Service data.
- 2) The number of Electronic Return Originators (EROs) with an Electronic Filing Identification Number (EFIN)** in each Zip, since these are the preparers who could offer RALs to their clients if they so chose.
 - a.** As mentioned in the map legend, the dots on the map represent the number of EROs within a Zip code, but do not correspond to an exact location.
 - b.** Many of the Zip codes with high numbers of EROs also saw a large percentage of EITC recipients purchasing RALs (e.g. most of Raleigh, Mercer and Summers Counties).
 - c.** Some regions of the state, such as McDowell County, had very high rates of RAL usage by EITC recipients, but only a handful of ERO preparers. In such cases, it is likely that individuals are driving a distance in order to have their taxes prepared and to purchase a RAL.
- 3) The locations of the Volunteer Income Tax Assistance (VITA) sites** throughout the state, as well as the number of EITC returns prepared for free by the sites in that city.
 - a.** Each city that is listed on the maps represents the location of a VITA site or sites. Note: the number that is reported next to each city reflects the EITC returns filed, not the total number of returns prepared for free.
 - b.** Some counties still lack even one VITA site (e.g. Fayette, Summers, Monroe). The need for more VITA sites is pressing, especially in areas where a large percentage of EITC recipients are using RALs.
- 4) The percentage of the population in each Zip code that was Black or African-American** in 2000, as there has been speculation that tax preparers are often located in minority neighborhoods and that RALs are targeted at Black communities.
 - a.** Areas of the state where more than 10 percent of the population is Black often have high concentrations of EROs and above average RAL usage by EITC recipients. In Raleigh County, most EROs are located in the Zip codes with 10-25 percent Black population. Similar trends are seen in Summers and Mercer Counties. In McDowell County, only one ERO is located in a Zip code that does not have a Black population over 10 percent.

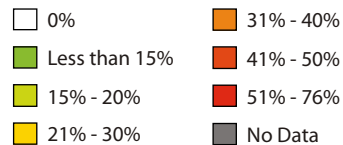
EITC Coalition 1: Southwest WV



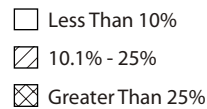
EITC Coalition 2: Eastern Panhandle



EITC Recipients Using RALS



Black Population

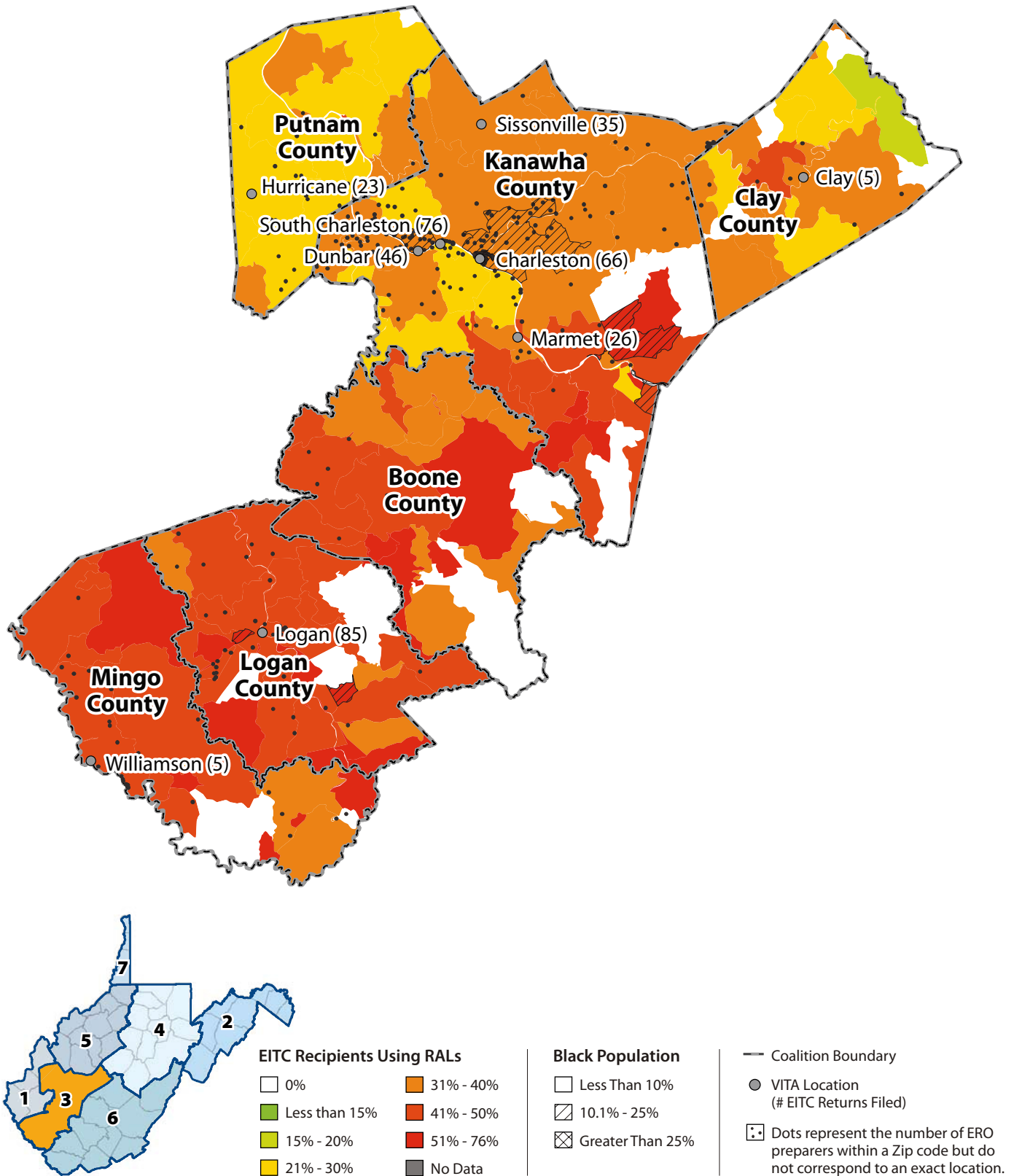


— Coalition Boundary

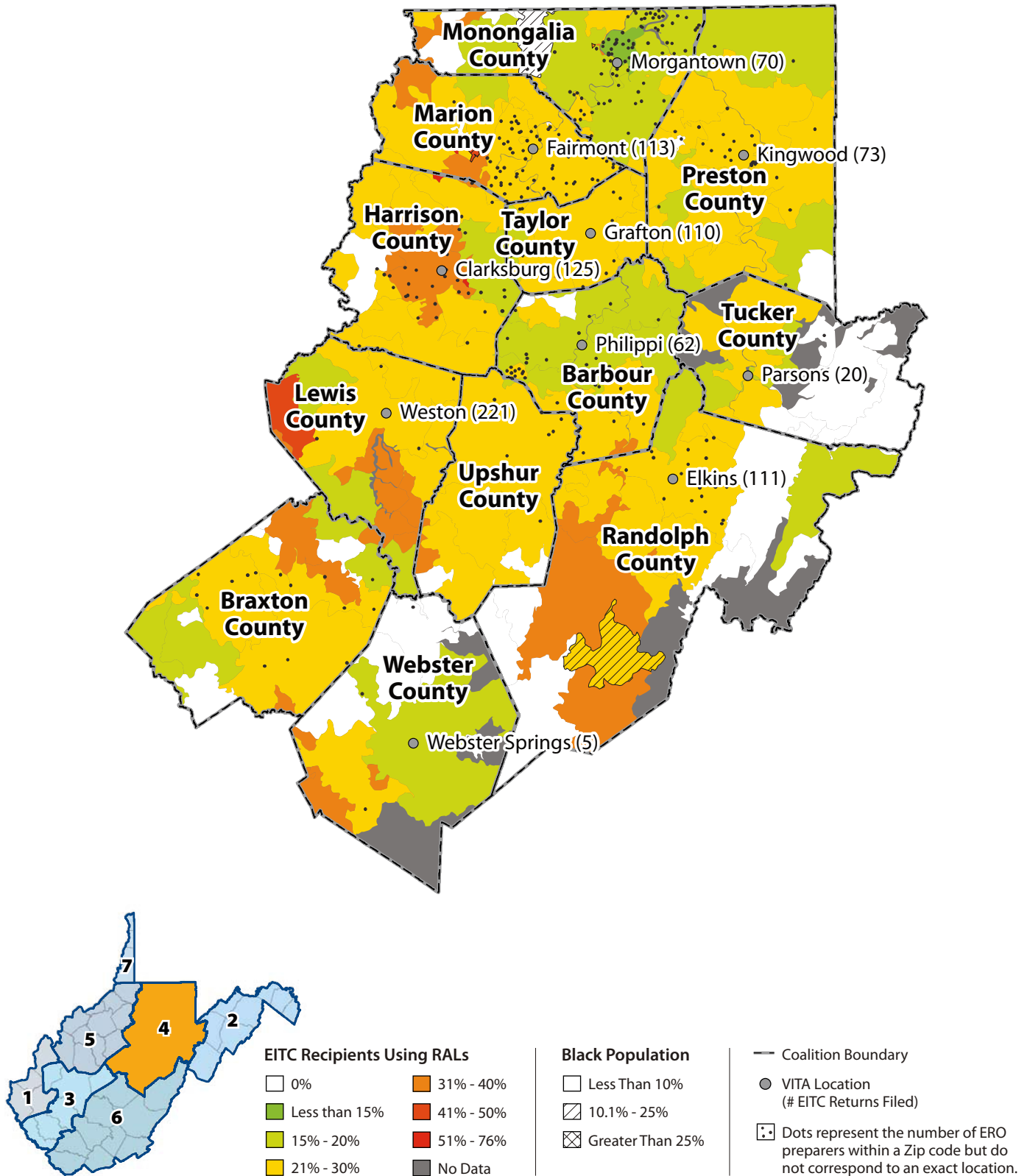
● VITA Location
(# EITC Returns Filed)

⬤ Dots represent the number of ERO preparers within a Zip code but do not correspond to an exact location.

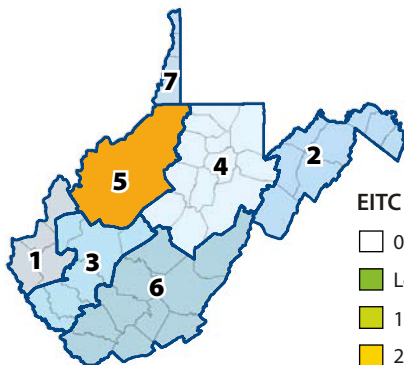
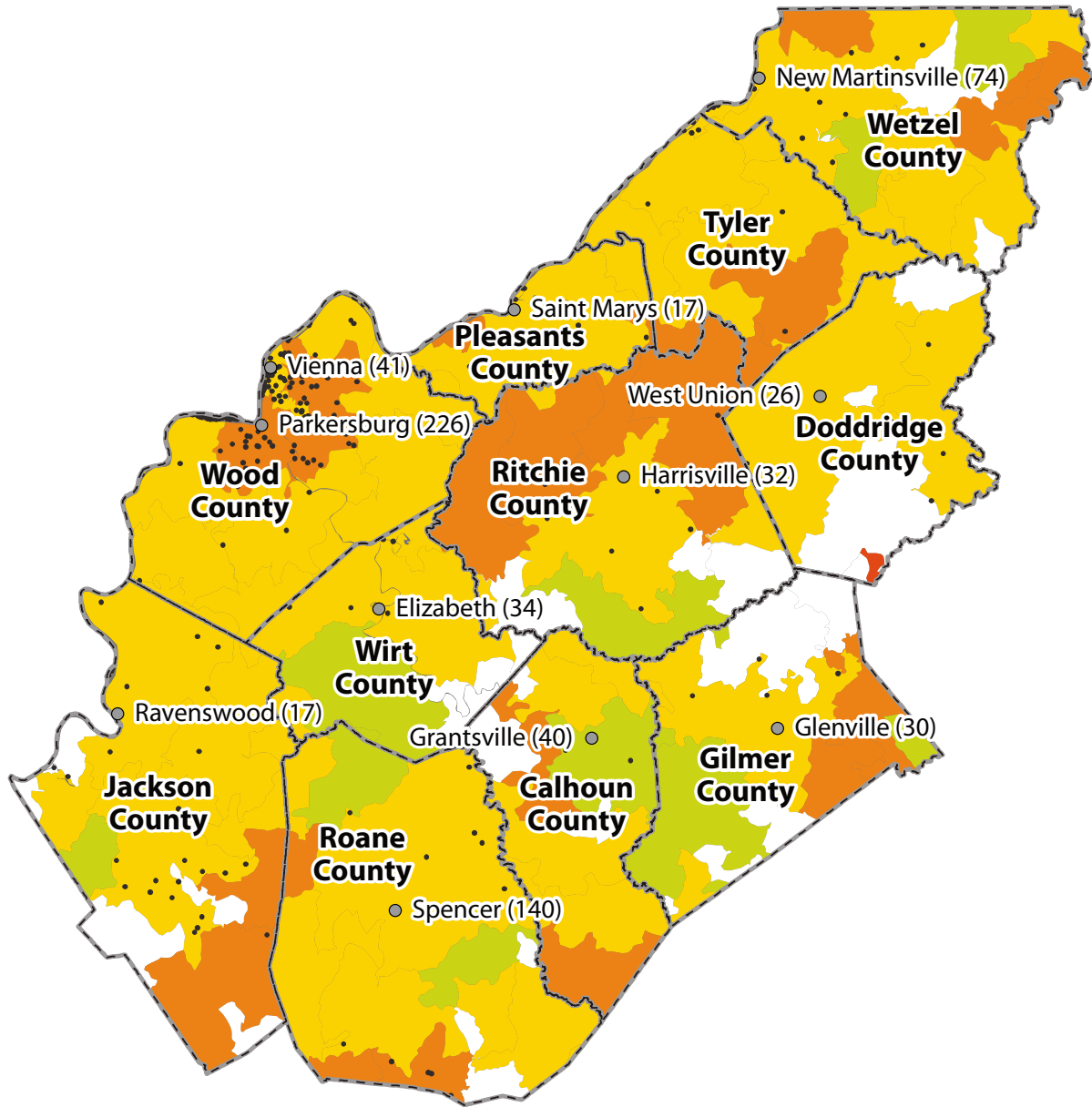
EITC Coalition 3: Central WV



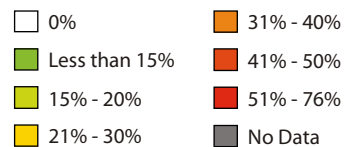
EITC Coalition 4: North Central WV



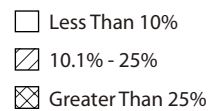
EITC Coalition 5: Mid-Ohio Valley



EITC Recipients Using RALS



Black Population

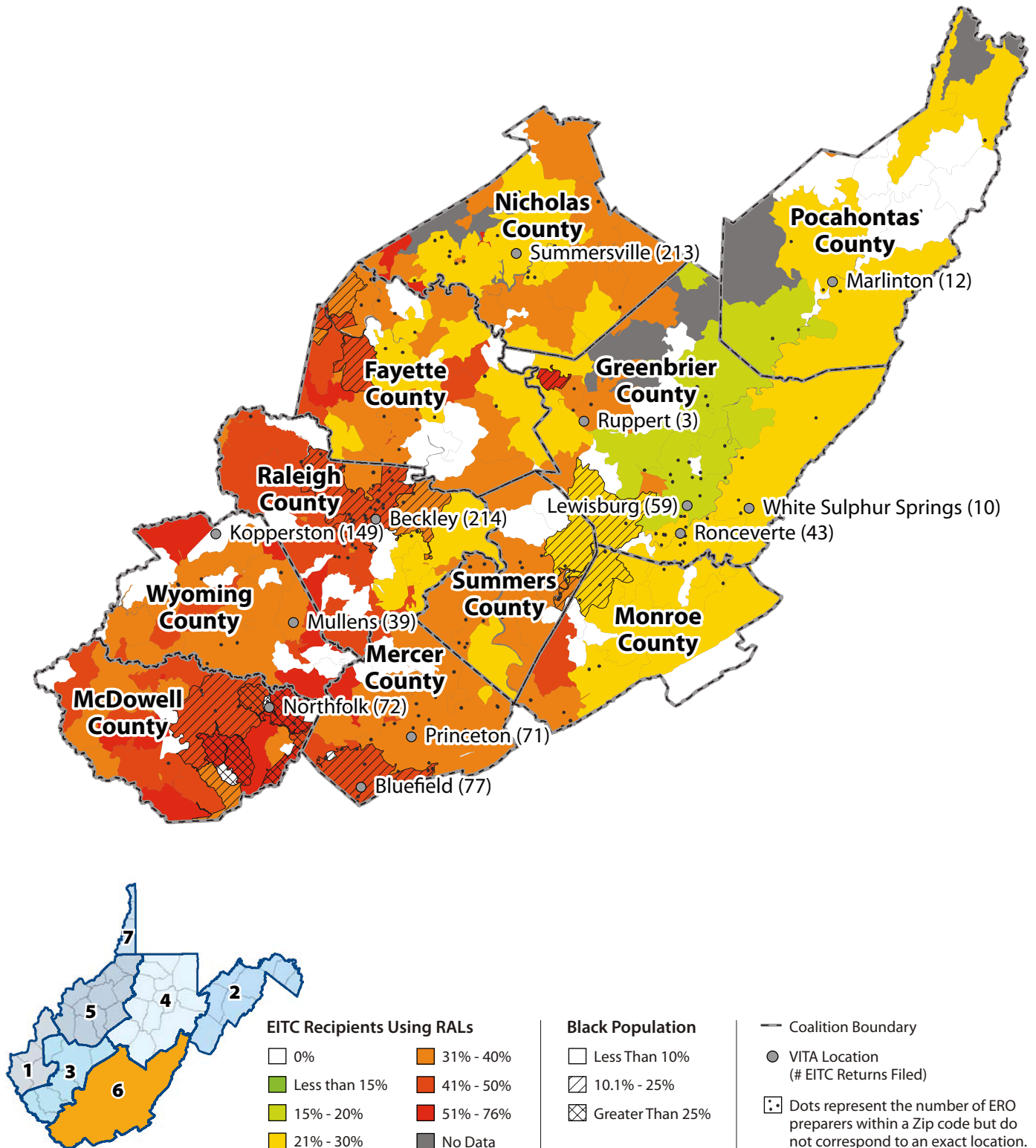


— Coalition Boundary

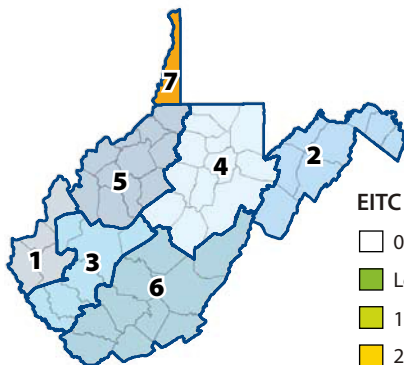
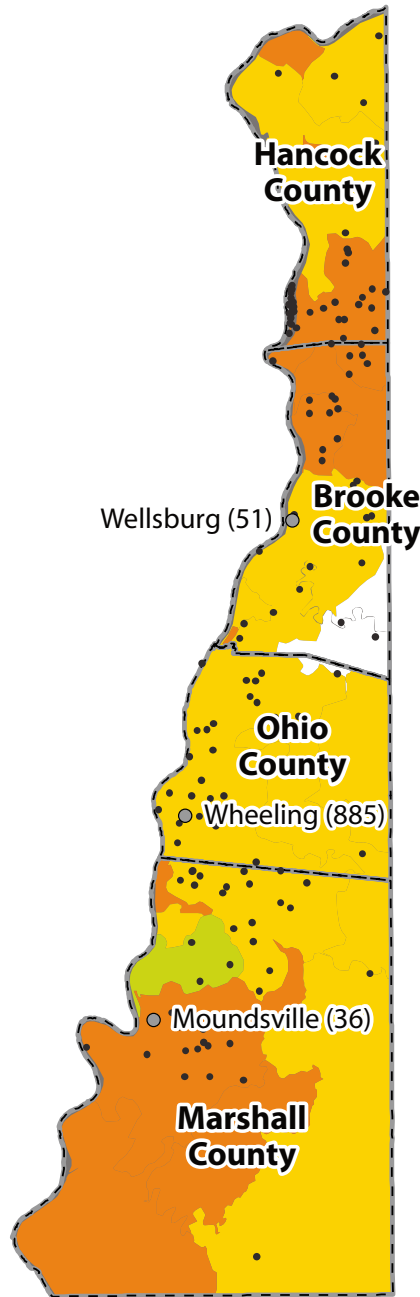
● VITA Location (# EITC Returns Filed)

⋯ Dots represent the number of ERO preparers within a Zip code but do not correspond to an exact location.

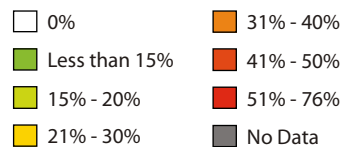
EITC Coalition 6: Southern WV



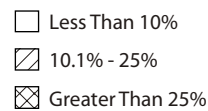
EITC Coalition 7: Northern Panhandle



EITC Recipients Using RALS



Black Population



— Coalition Boundary

● VITA Location
(# EITC Returns Filed)

⬤ Dots represent the number of ERO preparers within a Zip code but do not correspond to an exact location.

Endnotes

- 1 See: WV Code, Chapter 46a – The WV Consumer Credit and Protection Act. <http://www.legis.state.wv.us/WVCODE/Code.cfm?chap=46a&art=1> . See also: *Center for Responsible Lending. The Best Value in the Subprime Market: State Predatory Lending Reforms*. Feb. 2006. <http://www.responsiblelending.org/mortgage-lending/research-analysis/the-best-value-in-the-subprime-market-state-predatory-lending-reforms.html> (Accessed June 24, 2009)
- 2 Center for Responsible Lending. *Refund Anticipation Loans*. <http://www.responsiblelending.org/other-consumer-loans/refund-anticipation-loans/> (Accessed June 24, 2009)
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- 4 View the video online at: <http://www.racewire.org/archives/2009/03/magic-johnson-pitches-for-pred.html> (Accessed June 19, 2009)
- 5 According to CfED's Assets and Opportunity Scorecard, which utilizes U.S. Census Bureau's SIPP data, 24.7 percent of West Virginians held non-interest bearing accounts and 22.4 percent held interest bearing accounts. <http://www.cfed.org> (Accessed June 29, 2009)
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- 7 Center for Responsible Lending. *Refund Anticipation Loans*.
- 8 Data from the Brookings Institution's *EITC Interactive*. <http://www.brookings.edu/projects/EITC.aspx>
Calculations of summed totals and averages done by the West Virginia Center on Budget and Policy.



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