March 20, 2013

Defrauding the American Taxpayer: The Earned Income and Additional Child Tax Credits A 2013 Update

By Edwin S. Rubenstein
For *The Social Contract*

As Americans struggle to file and pay federal income taxes by April 15th millions of illegal immigrants are lining their pockets with tax refunds even if they have not paid a dime in income taxes. The Additional Child Tax Credit (ACTC) provides cash payments to low income parents who pay no income tax and lack a valid Social Security number. Most of these folks are in the country illegally.

The IRS makes it easy. The tax collection agency routinely issues an Individual Taxpayer Identification Number (ITIN) to individuals who file income tax returns but are not eligible to work in the U.S. Some of these go to foreign investors who pay federal income taxes on their U.S. holdings. They are not the problem. Most ITINs are issued to illegal immigrants who reside in the U.S. Many do not work. They file Federal income tax returns solely to receive the child tax credit refund.

A 2011 Treasury Department study reports that the number of ITIN filers claiming the child credit nearly doubled from 2005 to 2008 - from 796,000 to 1,526,276.[1] This period saw changes in the ACTC program that greatly expanded eligibility as well as the size of the refunds.

The same study accuses the IRS of paying illegal immigrants $4.2 billion in ACTC refunds in 2010. This amount equals one-fifth of all ACTC refunds paid that year.

A subsequent Treasury study found that **"…taxpayers repeatedly claimed erroneous Additional Child Tax Credits (ACTC) after being disallowed the previous year. The IRS could have saved more than $108 million by reviewing claims made by taxpayers who were previously disallowed the credit."**[2]

Fraudulent refunds are also common in the older, larger, and better known Earned Income Tax Credit (EITC.) On tax day 2009 we released a study of the program, noting that up to one third of all EITC refunds were based on illegal multiple returns, phony

---

[1] Treasury Inspector General for Tax Administration, *Individuals Who Are Not Eligible to Work in the United States Were Paid $4.2 Billion in Refundable Credits,* July 7, 2011. http://www.treasury.gov/tigta/auditreports/2011reports/201141061fr.pdf

[2] Treasury Inspector General for Tax Administration, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims*, September 7, 2012. http://www.treasury.gov/tigta/auditreports/2012reports/201240105fr.pdf

Social Security numbers, or claims of non-existent children or spouses.[3] This fraud enabled the EITC to become the largest cash transfer program for low-income families in the United States – dwarfing better known entitlements such as TANF (cash welfare) and Food Stamps.

EITC and ACTC are both designed to reduce taxes paid by low income families with children. They are "refundable" tax credits, meaning that if the amount of credit exceeds a filer's total tax liability the government pays the excess in cash.

The same folks claiming EITC refunds often claim ACTC cash also – with same intent to defraud. The Treasury Inspector General found that fraudulent EITC payments are accompanied by fraudulent ACTC payments on 67% of returns claiming both credits. Once again, the IRS is asleep at the switch:

"…The IRS could have prevented approximately $419 million in erroneous ACTC refunds from being released had it reviewed the ACTC at the same time that the EITC was being reviewed."[4]

The scandals have prompted at least one congressman to act. On September 21, 2012 Congressman Sam Johnson (TX) introduced the ITIN Reform Act.[5] The legislation would require people claiming ACTC refunds on tax returns filed without a Social Security number to verify their citizenship status in person at an IRS office. Currently the IRS sends these refunds automatically, with no questions asked.

"It's time to hold the IRS's feet to the fire when it comes to protecting taxpayer dollars," said Johnson. **"The IRS should be rooting out waste, fraud and abuse – not encouraging it."**

His bill died in committee. Immigrant groups opposed it, of course. But as detailed below, the IRS also expressed opposition to the safeguards embodied in Congressman Johnson's proposal.

Since the start of the Great Recession federal spending has expanded rapidly while tax revenues have declined. The deficit rocketed from $0.5 trillion in FY2008 to $1.4 trillion the following year. For FY2013 the Congressional Budget Office is forecasting a deficit of $845 billion. If correct, it will be the first time since 2008 the government hasn't had an annual deficit of more than $1 trillion[6].

---

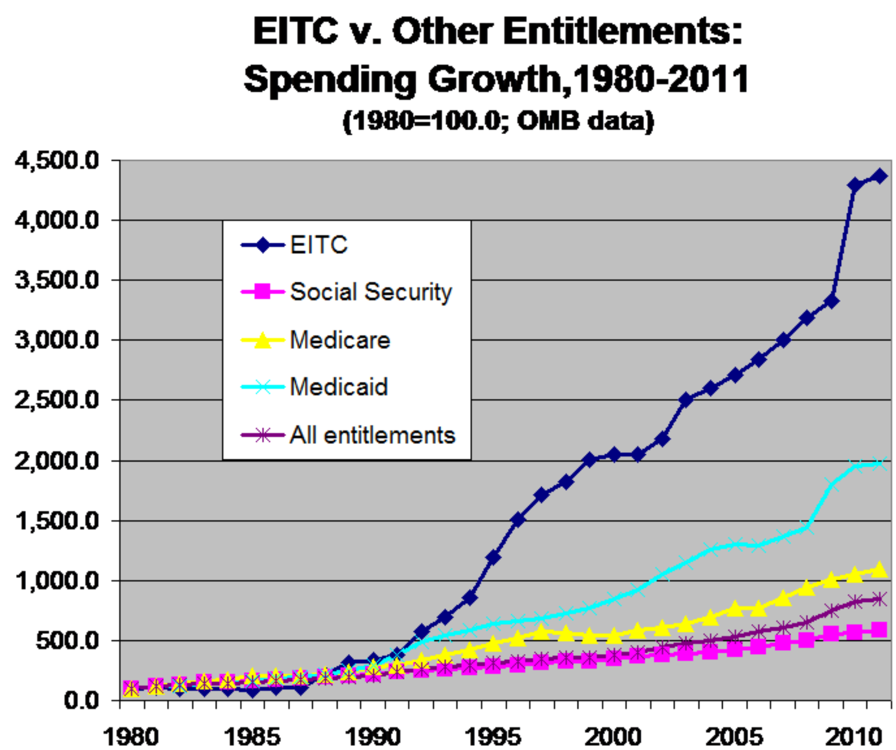
[3] Edwin S. Rubenstein, *The Earned Income Tax Credit and Illegal Immigration*, The Social Contract, Spring 2009. http://www.thesocialcontract.com/artman2/publish/tsc_19_3/index.shtml
[4] http://www.treasury.gov/tigta/auditreports/2012reports/201240105fr.pdf
[5] *Johnson Introduces ITIN Reform Act*, September 21, 2012. http://samjohnson.house.gov/news/documentsingle.aspx?DocumentID=309496
[6] Associated Press, *January surplus shrinks 2013 US budget deficit*, February 12, 2013. http://www.foxnews.com/politics/2013/02/12/january-surplus-shrinks-2013-us-budget-deficit/

The improvement will be short lived, however. The implementation of Obamacare along with the retirement of more baby boomers claiming Medicare and Social Security will push the deficit back to the $1 trillion level by 2023, according to the CBO.

Entitlement reform is essential if we are serious about cutting the deficit. Reductions in Medicare, Medicaid, and other once "untouchable" entitlements have been proposed. But the Child Tax Credit? No way. Neither party has shown any interest in cutting the program.

The Bush tax cuts of 2001 and 2003 doubled the size of the Child Tax Credit from $500 to $1,000 per child. Those expansions were renewed by Obama in 2009 – but were slated to expire in 2013. The American Taxpayer Relief Act of 2012, enacted in response to the "fiscal cliff" emergency on New Year's Day 2013, made the expansions permanent.[7]

The refundable portions of the CTC and EITC are projected to cost taxpayers a combined $84 billion in 2013 – with most of this coming from the EITC. For decades EITC expenditures have grown far faster than those of better known entitlement programs:



[7] Center for Budget and Policy Priorities, *Policy Basics: The Child Tax Credit*, February 1, 2013.

In 1980 EITC was a $1.275 billion program. By 2011 it had grown to $55.65 billion – a 43.6-fold increase in 31 years. Over the same period Social Security spending increased by 5.8-fold, Medicare was up 11.0-fold, Medicaid grew 19.7-fold, and total entitlement spending rose by a factor of 8.4.

Today EITC is the most expensive cash entitlement program for low-income families. It is not as expensive as the health giants – Medicare and Medicaid – or Social Security. But if these absurdly high rates of EITC growth persist it will inevitably become the largest federal entitlement of all.

Yet no one seems to care.

One reason for its relative anonymity: EITC is part of the income tax code. (That's why we chose April 15th to release this article.) The tax code is vast - it contains many different deductions, allowances and credits – of which the EITC is one of the most generous – and important. The credit is not subject to the Congressional budget authorization process.

The Obama Administration has gone out of its way to promote the EITC and the tax credit. A November 2011 White House report directed specifically to African Americans notes the **"…historic expansions in refundable tax credits Earned Income Tax Credit and Child Tax Credit for low income families."**[8]

EITC is applauded for bringing great gains to Blacks:

"Earned Income Tax Credit (EITC). The EITC is a refundable tax credit primarily for low-income working families with children. This tax credit has lifted more children out of poverty than any other single program or category of programs. Under the Recovery Act, the Obama Administration expanded the EITC by creating a "third tier" for families with three or more children, allowing them this year to receive up to $640 more than they otherwise would. The Administration's expansion of the EITC kept 95,000 African Americans above the poverty line in 2010 alone. This tax credit enables a newly employed single mother of two to supplement her earnings with EITC as soon as she starts work. If this mom earns $20,000 a year, she stands to receive an EITC of around $4,400 for her family."[9]

In the static analysis favored by the Obama Administration the credit may indeed appear to "raise" thousands of African-Americans out of poverty. But this conclusion focuses solely on the cash received by EITC recipients. It ignores the deleterious impact of EITC on minority wages, family size, and debt. It also turns a blind eye to evidence

---

[8] The White House, *The President's Agenda and the African American Community*, November 2011. http://www.whitehouse.gov/sites/default/files/af_am_report_final.pdf
[9] Ibid.

that EITC encourages illegal immigration, a side-effect which in the long run hurts minorities more than EITC money helps them.[10]

At the end of the day deficit reduction, by lowering interest rates and increasing private sector confidence, may be the best anti-poverty program of all. But by touting the EITC Mr. Obama greatly reduces the chances for a smaller deficit.

The FY2014 Federal Budget, which normally would be released in February 2013, has been delayed due to sequestration and the ensuing fiscal gridlock. The budget document released in February 2012 (latest available at this writing) estimated EITC outlays would be $52.2 billion in FY2012 – up 29% from FY2008. By comparison outlays of the notoriously hard to control Medicaid program were expected to rise 27% over that period:

EITC v. Other Federal Entitlement Spending, 2008-2012 Est.

Program	FY2008	FY2012Est.	% increase
EITC	**$40.6**	**$52.2**	**28.6%**
Medicaid	$201.4	$255.3	26.8%
Medicare	$223.6	$264.0	18.1%
Social Security	$506.6	$635.2	25.4%
Food Stamps	$39.3	$85.2	116.8%
TANF (cash welfare)	$21.8	$20.4	-6.4%
All Entitlements. ($ trill.)	$1.83	$2.37	29.6%
All Federal outlays ($ trill.)	$2.97	$3.80	27.7%

Data source: OMB, FY2013 Budget. Tables 1.1 and 11.3.

Compare the trend of EITC outlays with that of TANF, another program providing cash to the poor. Formerly Aid to Families With Dependent Children, TANF is widely perceived as a program that does more harm than good, exacerbating poverty by destroying work incentives. Restricting TANF eligibility was the centerpiece of Bill Clinton's pledge to "end welfare as we know it." As a result there are fewer TANF recipients today than during the Clinton boom years. Despite sharply higher unemployment and poverty rates, welfare spending is expected to decline by 6.4% between 2008 and 2012.

Cash welfare carries a stigma – even among the poor. Why, then, does the EITC remain so popular?

Enthusiasm for the program stems from the perception that, unlike traditional welfare, the tax credit is only available to the working poor, especially families with children. In addition, while welfare benefits decline as a recipient's earnings go up, EITC benefits go up when workers make more – thereby increasing work incentives for low income individuals.

[10] These side effects are discussed in my Spring 2009 TSC article.

From a distance the EITC looks like a winner. The devil is in the details.

EITC fraud

Technically only taxpayers with valid Social Security numbers who are authorized to work in the U.S. are eligible for the tax credit. But identity theft, stolen Social Security numbers, and other scams have effectively nullified the restriction. As a result, illegal aliens actually receive the EITC at even greater rates than legal immigrants.

Four years ago we reported that households headed by illegal immigrants from Mexico were three times more likely to receive the EITC than households headed by native-born Americans.[11] We noted that the IRS does little to verify the validity of SSNs used to file for EITC refunds, or the existence of immigrant children claimed on such returns, or to ascertain that they've lived with the taxpayer for more than 6 months as required by law. Illegal alien husbands and wives often file separate returns in which both spouses claim the same children.

The Treasury Department has, in effect, confirmed our conclusions. An audit by the Department's inspector general stated the following:

"The Government Accountability Office has listed the Earned Income Tax Credit (EITC) Program as having the second highest dollar amount of improper payments of all Federal programs. The Internal Revenue Service (IRS) has made little improvement in reducing EITC improper payments since 2002 when it was first required to report estimates of these payments to Congress. The IRS continues to report that 23 percent to 28 percent of EITC payments are issued improperly each year. In Fiscal Year 2009, this equated to $11 billion to $13 billion in EITC improper payments."[12]

More recently GAO estimated the error rates – the percent of total payments issued improperly - of the 10 largest federal transfer programs:

[11] Edwin S. Rubenstein, *Defrauding the American Taxpayer: the Earned Income Tax Credit and Illegal Immigration,* The Social Contract, Spring 2009.
[12] Treasury Inspector General For Tax Administration, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* February 7, 2011. http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf

Improper Payment Estimates: 10 Programs with highest reported amounts, FY 2011			
		Improper payments	
Program	**Agency**	**Dollars (bils.)**	**Error rate (%)**
EITC	Treasury	$15.2	23.5%
School lunch	Agriculture	$1.7	16.0%
Unemployment insurance	Labor	$13.7	12.0%
Medicare advantage	HHS	$12.4	11.0%
Supplemental Security Income	Social Security	$4.6	9.1%
Medicare fee for service	HHS	$28.8	8.6%
Medicaid	HHS	$21.9	8.1%
Supplemental nutrition assistance	Agriculture	$2.5	3.8%
Medicare prescription drug Benefit	HHS	$1.7	3.2%
OASDI	Social Security	$4.5	0.6%
Data source: General Accountability Office, *Moving Forward with Governmentwide Reduction Strategies*, 2012. Table 1. http://www.gao.gov/assets/590/588228.pdf			

At 23.5%, the EITC's improper payment rate is by far the highest among the 10 largest federal transfer programs. EITC's rate was exactly five-times larger than the 4.7% error rate OMB estimated for all $2.5 trillion of federal spending that year.

[The table does not include the Child Tax Credit (CTC), much of which is received illegally by illegal aliens not eligible to work in the U.S. As described below, the IRS does not consider these payments "improper" if the tax return claiming the credit has an Individual Taxpayer Identification Number instead of a valid Social Security number.]

Primary causes of erroneous EITC payments are given as follows:[13]

- Complexity of the tax law
- Structure of the program
- Confusion among eligible claimants
- High turnover of eligible claimants, and
- Unscrupulous return preparers

The IRS shows no urgency in cracking down on fraudulent EITC payments:

"TIGTA [Treasury Inspector General for Tax Administration] **has conducted a number of audits that have provided the IRS with specific actions that could be taken to reduce improper payments. While the IRS has implemented some of our recommendations, it has not taken actions to address key recommendations aimed at preventing/reducing EITC improper payments."**[14]

Illegal immigration is not specifically mentioned as a source of EITC fraud, but the use of bogus Social Security numbers and other actions associated with the receipt of

[13] GAO, 2012. http://www.gao.gov/assets/590/588228.pdf
[14] TIGTA, 2011. http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf

EITC by illegal aliens are prominently highlighted. Once again, the IRS is asleep at the switch:

Recommended EITC Actions That IRS Has Not Taken	
Action	Potential Savings (Over 5 years)
Comply with regulations requiring some taxpayers who previously filed a fraudulent EITC claim to recertify their eligibility before receiving the EITC in a subsequent tax year.	$330 million
Ensure taxpayers comply with the law governing EITC qualifying-child eligibility before allowing EITC claims.	$5.6 billion
Use available third-party data to ensure taxpayers comply with the law requiring individuals to have a Social Security Number that is valid for work when claiming the EITC.	$1.1 billion
Source: Treasury Inspector General For Tax Administration, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* February 7, 2011. Figure 3.	

The Treasury Department's Inspector General is not optimistic that its tax collection agency will clamp down on the massive fraud:

"The loss of billions of dollars in improper EITC payments annually calls for more aggressive and immediate actions to reduce improper payments by intensifying efforts to eliminate payment error, waste, fraud, and abuse. Executive Order 13520 requires the IRS to intensify its efforts and set targets to reduce EITC improper payments. The IRS has not met this requirement and, as a result, the risk remains high that no significant improvement will be made in reducing improper EITC payments."[15]

Another (Even Worse) Tax Credit

The Child Tax Credit (CTC) was signed into law in 1997.

The Obama White House loves the CTC:

Child Tax Credit (CTC). The CTC reduces the amount of federal taxes low-income families must pay by up to $1,000, depending on family income, for each qualifying child under the age of 17. For example, a family of four that could otherwise owe $4,000 in taxes might only owe $2,000 after receiving the credit for each of their children. Though the Child Tax Credit was expanded to a maximum of $1,000 per child from $500 per child in 2003, the credit remained unavailable to

[15] TIGTA, 2011, page 10. http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf

millions …. In the Recovery Act, the Obama Administration worked with Congress to expand the Child Tax Credit to lower the minimum earned income amount for refundability from about $12,500 to $3,000—giving many families access to thousands of dollars in additional tax benefits that would have otherwise been lost…. The Administration's expansion of the CTC kept 199,000 African Americans above the poverty line just in 2010.[16]

CTC is potentially more damaging than the EITC. While EITC payments max out at three-children, CTC payments rise by as much as $1,000 for *every* child in a family. And while EITC payments are phased out as poor families approach the poverty line, households with incomes as large as $130,000 are eligible for the CTC.

Then there is the matter of fraud. By law illegal aliens are not eligible for either the EITC or the CTC tax credit. In practice the IRS make little effort to ascertain the validity of Social Security numbers used in filing tax returns. Many of those Social Security numbers are fraudulent - stolen from citizens by illegal aliens who then file for the tax credit.

But at least the IRS requires EITC recipients to go through the charade of appearing eligible to work in the U.S. by obtaining a Social Security number.

By contrast, IRS pays CTC refunds to *any* taxpayer claiming the benefit, whether filing with a Social Security number or not. This includes returns filed with Individual Taxpayer Identification Numbers (ITINs)

The refundable part of the CTC is called the Additional Child Tax Credit (ACTC.) When a taxpayer's CTC payment exceeds his tax liability, IRS sends an ACTC refund check to cover the balance. Individuals can receive an ACTC refund check even if no income tax was withheld or paid.

A Treasury Department audit released in July 2011 accused the IRS of allowing undocumented workers to collect $4.2 billion in ACTC credits in 2010 – almost four-times the amount five years earlier. The $4.2 billion represented nearly one-fifth of all ACTC payments that year.

The audit exposed deplorable management of the ITIN application process, with IRS managers encouraging employees to ignore questionable applications and blatant fraud for the sake of fast-tracking ITIN approvals. When confronted, the IRS explains that ITINs are "for tax purposes only," that they help people here illegally comply with the tax code and, are not intended for any other purpose.

The IRS insists that the tax code permits the payment of ACTC, but not the EITC, to undocumented workers. This makes no sense. The ACTC was specifically designed to offset some of the work disincentives created by the phase-out of the EITC. Indeed, ACTC benefits

[16] The White House, *The President's Agenda and the African American Community*, November 2011, page 5. http://www.whitehouse.gov/sites/default/files/af_am_report_final.pdf

phase in at the income levels where EITC starts to phase out. http://www.taxpolicycenter.org/briefing-book/key-elements/family/ctc.cfm The credits are inextricably linked.

Appropriations for EITC and ACTC credits in FY 2010 were $54.7 billion and $22.7 billion, respectively. They are by far the most expensive refundable tax credits.

The EITC alone is sufficient for very low-income households with children. The EITC reaches its maximum level of $5,751 for families with three or more children earning $12,000 to $21,000 in 2011 (after which point it starts to phase out). But, unlike the ACTC, the EITC reaches a maximum at three children. Also, the maximum ACTC benefit has doubled – from $500 to $1,000 a child – since the credit was first enacted. And unlike the EITC, child tax credits are available to families with incomes well above the poverty level.

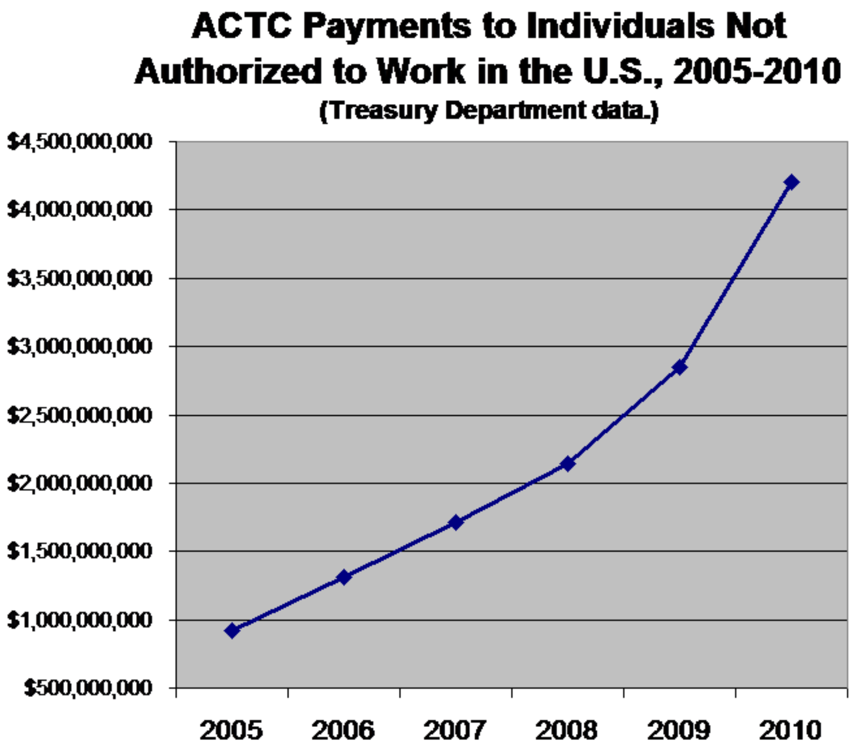
Even the liberal Urban Institute has questioned logic of having two refundable tax credit programs with different income requirements:

"**Viewed as a work incentive, the CTC phase-in rules are logical (although there is a question as to why lower-income households should be subject to work incentives delivered by two separate programs-the EITC and the CTC). For the majority of recipients, however, the CTC is tantamount to a cash allowance. Viewed simply as a child subsidy, it is hard to understand why the families who most need help are excluded."**[17]

Bottom line: the Child Tax Credit is a very inefficient way to help genuinely poor families with children.

It is also clear that an increasing share of the costs associated with the child tax credit are going to illegal aliens. ACTC refunds paid to individuals filing with ITINs – most of them not authorized to work in the U.S. - have skyrocketed:

[17] http://www.taxpolicycenter.org/publications/url.cfm?ID=411232#n1

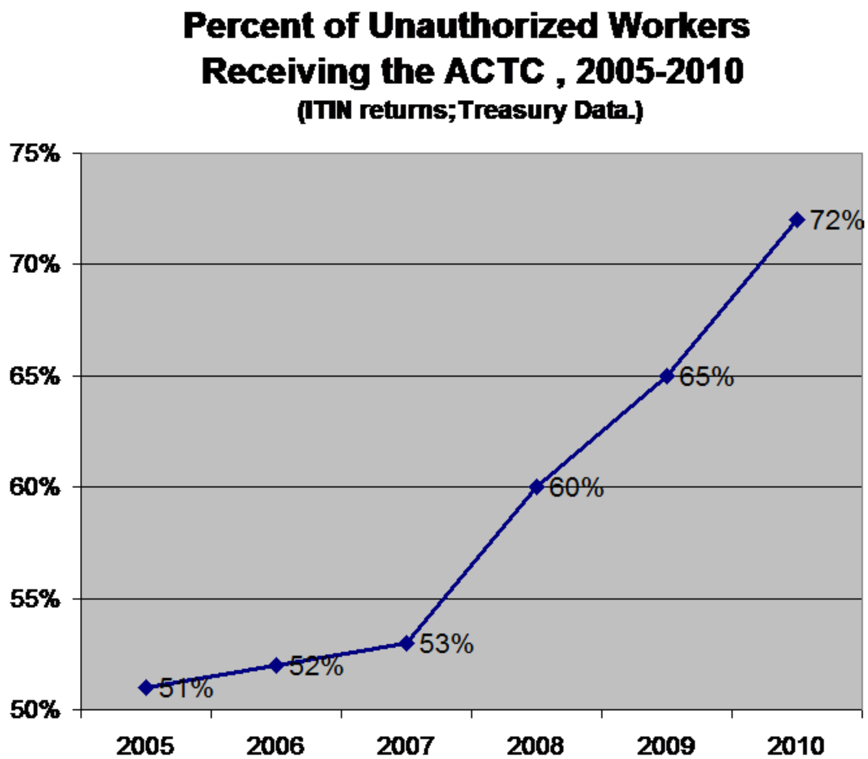


In 2005 796,000 ITIN filers received ACTC totaling $924 million. By 2008 1,526,276 ITIN filers received $2.1 million in ACTC payments.

Then came the Great Recession. The American Recovery and Reinvestment Act of 2009 increased ACTC benefits for both legal and illegal workers. The Act lowered the threshold income at which ACTC kicks in to $3,000 from $12,500.

The predictable result: more illegal alien recipients and a larger payment per recipient. By 2010 2.3 million ITIN filers claimed ACTC totaling $4.2 million. The average ACTC payment per illegal alien (ITIN) tax return rose from $1,399 in 2008 to $1,803 in 2010.

ACTC fraud is not limited to returns filed with an ITIN. In fact, the credit is received by more taxpayers filing with Social Security numbers than with ITINs. However, ITIN taxpayers are far more likely to claim ACTC benefits. In 2010, for example, 72% of all ITIN filers claimed the ACTC versus only 14% of individuals who filed tax returns with a Social Security number. More importantly, the fraction of ITIN tax returns claiming the ACTC has increased dramatically:



The inescapable conclusion: IRS knowingly enables illegal aliens to defraud honest taxpayers. It has allowed itself to become a political arm of the Obama Administration.

Sen. Orrin Hatch (R-Utah), ranking member of the Senate Finance Committee, takes the Administration and its compliant tax agency to task:

"The disconcerting findings in this report demand immediate attention and action from Congress and the Obama Administration," Hatch said when the Treasury report was issued. **"With our debt standing at over $14.5 trillion and counting, it's outrageous that the IRS is handing out refundable tax credits...to those who aren't even eligible to work in this country."**

"**Many individuals who are not authorized to work in the United States, and thus not eligible to obtain a Social Security Number (SSN) for employment, earn income in the United States. The Internal Revenue Service (IRS) provides such individuals with an Individual Taxpayer (ITIN) to facilitate their Department of the Treasury to seek clarification filing of tax returns. Although the law prohibits aliens residing without authorization in the United States from receiving most Federal public benefits, an increasing number of these individuals are filing tax returns claiming the claiming the Additional Child Tax Credit (ACTC), a refundable tax credit intended for working families. The payment of Federal funds through this tax benefit appears to provide an additional incentive for aliens to enter, reside, and**

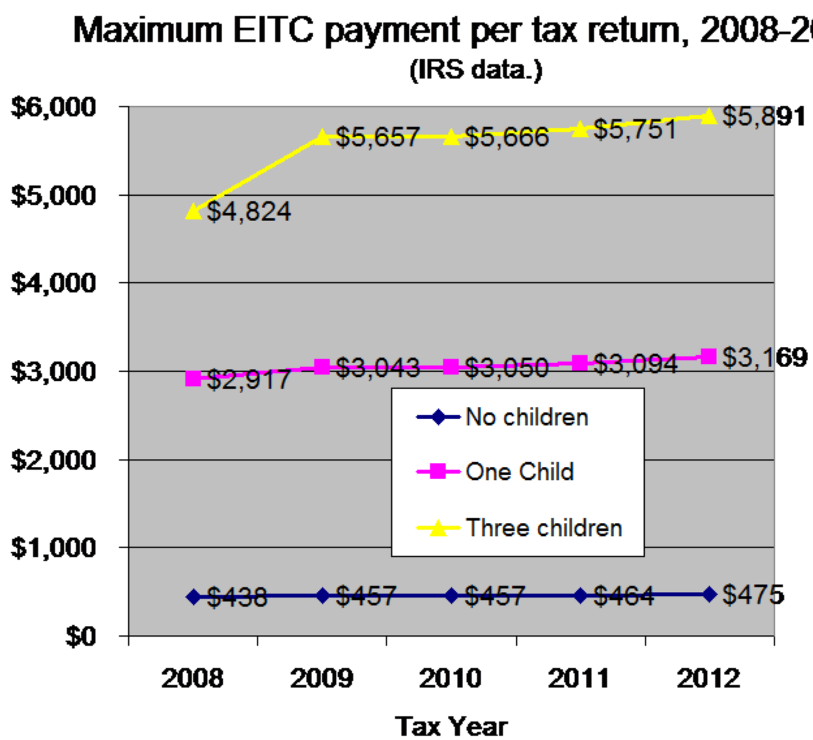
work in the United States without authorization, which contradicts Federal law and policy to remove such incentives."[18]

Tax Credits Fuel Population Growth

Four years ago we wrote:

"EITC originated as an income supplement for low income workers. Somewhere along the line its purpose seems to have changed. Today it is a program whose benefits are heavily contingent on parenthood." [19]

Since we wrote those lines EITC's pro-procreation bias has become even more pronounced. The reason: a fourth EITC bracket – for families with three or more children – was added in 2009. This significantly increased the financial incentive to have children:



In 2008 a family with no children received a maximum EITC payment of $438; a family with one child received up to $2,917; two or more children bumped the maximum credit to $4,824. Thus the presence of children triggered an 11-fold rise in EITC payments ($438 to $4,824) in 2008.

---

[18] http://www.treasury.gov/tigta/auditreports/2011reports/201141061fr.pdf

[19] Edwin S. Rubenstein, *Defrauding the American Taxpayer: the Earned Income Tax Credit and Illegal Immigration*, The Social Contract, Spring 2009.

On tax returns filed this April (tax year 2012) childless families are eligible for an EITC payment of up to $475; a family with three or more children will receive up to $5,891. Thus the presence of children can trigger a 12.4-fold rise in EITC payments – $5,891 versus $475.

By having children a family can increase its EITC payment by as much as $5,416 today versus $4,386 in 2008. That's an increase of $901, or 23.5% in EITC's pro-procreation incentive.

Not surprisingly, the IRS estimates that roughly half of improper EITC payments involve fraudulent child custodial claims.
.

But most children claimed on EITC tax returns are real – and therein lies the problem. The decision to have children may be influenced, at least in part, by the tax credit. The pro-procreation incentives are particularly acute for immigrants – for the simple reason that the credit represents a larger share of their incomes.

The Census Bureau projects that immigrants and their U.S.-born children will account for 79.5 percent of U.S. population growth between 2010 and 2050. U.S.-born children of immigrants, not the immigrants themselves, are expected to be the major driver. While native-born women are having fewer babies, fertility among their foreign born counterparts has generally continued to increase

Over the nearly 40-years of EITC's existence the share of births to foreign-born mothers has risen faster than the foreign-born share of the U.S. population.

It would be absurd to suggest that immigrants have children solely to get a larger tax credit. At the same time, groups with the highest EITC eligibility rates also have the highest fertility rates. Even a tiny increase in fertility rates, if maintained over the decades, will have enormous consequences.

The role of the EITC in the nation's demographic destiny cannot be denied.

EITC and the Culture of Debt

For poor families, the tax refund check is often the largest single sum of money they receive during the year. They may need the money immediately, however. Refund Anticipation Loans (RALs) give them cash quickly - sometimes in the same day or even within an hour of filing their tax returns. But they are costly.

Nearly three-quarters of all EITC recipients hire commercial tax preparers to do their returns. It not so much the tax preparation – it's the loans – the instant cash - that attracts so many poor taxpayers to these companies. And for the H&R Blocks of the world, it's big money. When you add up the interest payments, preparation costs, and other fees, an EITC recipient can spend more than 10% of the credit just to receive the credit.

Our 2009 study[20] detailed the risks RALs pose to borrowers:

"The mechanics of RALs are stacked against the taxpayer. Commercial tax preparers like H&R Block act as loan brokers, but banks actually issue the refund loans. Before transferring the RAL proceeds to the taxpayer the banks deduct interest, the tax preparer's fees, loan application fees, and all other charges. As part of the RAL process, the taxpayer must authorize the IRS to send the refund directly (electronically) to the bank to repay the loan.

The hapless EITC beneficiary is responsible for paying the loan in full no matter how much of the anticipated refund the IRS actually releases. The IRS can deduct any outstanding federal debts – e.g., back taxes, child support, or student loans – from the EITC payment. If the taxpayer cannot repay the RAL, the lender may send the account to a debt collector."

There is good news and bad news on the RAL front.

Good news: In 2010 the IRS announced a policy that increased the financial risk for commercial tax preparers and banks that issue RALs. Starting with the 2011 tax year the tax agency will no longer provide these companies with the "debt indicator" used to facilitate the loans. The debt indicator is simply an IRS e-mail sent to tax preparers after they file an electronic tax return. It contains information on back taxes owed, unpaid child support, or other payments their client owes the federal government - monies that can be deducted from EITC refunds.

In announcing the change IRS Commissioner Doug Shulman stated that **"as we prepare for tax season every year, we look at past practices and consider whether they still make sense. We no longer see a need for the debt indicator in a world where we can process a tax return and deliver a refund in 10 days. We encourage taxpayers to use e-file with direct deposit so they can get their refunds in just a few days."**[21]

The change will likely reduce the availability and volume of RALs issued by private tax preparation services:

"It is still unknown what the short-term and long-term impact of this decision will be on the RAL industry. However, for smaller tax preparers it is likely that they will think twice about offering RALs during the 2011 tax season. On the

---

[20] http://www.thesocialcontract.com/artman2/publish/tsc_19_3/index.shtml

[21] IRS, *IRS Removes Debt Indicator for 2011 Tax Filing Season*, August 5, 2010. http://www.irs.gov/newsroom/article/0,,id=226310,00.html

other hand, some of the bigger tax preparation companies may look for alternative ways to offer RALs while raising the cost. These larger companies may rely on a returning customer's debt indicator from prior years or on a taxpayer's credit score. Either way, it is becoming more difficult and more risky for these companies to offer refund anticipation products. Even before the IRS announced the elimination of the debt indicator, many banks who had previously provided RAL loans decided to get out of the risky RAL business…"[22]

Bad news: By pushing commercial companies out of the EITC business the IRS is increasing the clout of liberal activist groups that offer free tax preparation service. Foremost among them: The Center on Budget and Policy Priorities (CBPP).

CBPP has harnessed a large network of community organizations, schools, state and local governments, labor unions, and advocacy groups to its EITC outreach campaign. Members receive a "Tax Credit Outreach Campaign Kit"– updated annually – outlining CBPP's strategy for promoting the credit and linking eligible workers to free tax filing assistance. Flyers in Hmong, Tagalog, and eighteen other languages - designed to hook immigrants into the EITC culture - are prominent features. [23]

In recent years CBPP has lobbied for expanding eligibility and increasing EITC payment amounts. The clamp down on RALs is unlikely to offset the expansion of a program so beloved by liberal activists – and the White House.

---

[22] Community Tax Coalition, *IRS Announces New policy Affecting Refund Anticipation Loans*, August 2010. http://tax-coalition.org/policy-resources/consumer-protections/refund-anticipation-loans/debt-indicator-fact-sheet

[23] Center on Budget and Policy Priorities, *2011 Tax Credit Outreach Kit.* http://eitcoutreach.org/category/outreach-tools