

Research and Policy Brief

The Earned Income Tax Credit in Los Angeles County: Trends and Opportunities

by Edmund Khashadourian, Joseph Martinez and Bill Pitkin

Background

History

The Earned Income Tax Credit (EITC) is one of the longest running and largest cash assistance programs for families in the US. The “nation’s largest antipoverty program for working families”¹- as it is also known - was created in 1975 with the dual purpose of alleviating poverty and providing incentives for people (especially for those with children) to earn or work more. EITC is available to qualified working individuals who have a valid Social Security number and are current legal U.S residents.

EITC has proven politically attractive among both liberals and conservatives. For liberals, EITC is a popular way of helping the working poor (especially those earning minimum wage) in a way that is direct and simple to understand. Conservatives like EITC because it requires recipients to work and is therefore not seen as a handout. Over the years, EITC has grown in size, and in 1986, with the Tax Reform Act, the value of EITC was indexed to inflation. In the 1990s, President Bill Clinton expanded the EITC program by increasing the maximum credit by \$1,500 and increasing the income limit by nearly \$4,000, allowing more people to apply. Several states have used the federal EITC program as a model for similar programs at the state level.

Eligibility and National Trends

For tax year 2007, individuals and families who are eligible for EITC can receive up to \$4,716 in tax credits, depending on family size and income.²

EITC Eligibility

Family Status	Earns up to
Single with no children	\$12,590
Married filing jointly with no children	\$14,590
Single, or head of household, with one child	\$33,241
Married filing jointly with one child	\$35,241
Single, or head of household, with 2+ children	\$37,783
Married filing jointly with 2+ children	\$39,783



Did you know?

An estimated 15% to 20% of those eligible for EITC in the U.S. do not claim the refundable credit.

In 1975, the first year that EITC was implemented, approximately 6.2 million claims were filed.³ Today, there are more 20 million taxpayers across the nation who receive EITC. From 2000 to 2004, the number of EITC filers nationally has gone up 15% from 18.8 million people to 21.7 million.⁴ About 17% of all tax filers claim EITC, with a slightly higher proportion in urban areas (around 20%). An estimated 15% to 20% of those eligible for EITC in the U.S. do not claim the credit.⁵

EITC claimants are more likely than other taxpayers to take out Refund Anticipation Loans (RALs) from commercial tax preparers and their financial partners. Labeled as “fast cash”, “instant refund”, or “express money,” RALs are essentially high cost loans paid directly from the refunds that tax filers are expected to receive from the IRS on their taxes. The fee structures that are built into RALs (such as administrative fees, loan fees, and tax preparation fees) effectively make them high interest loans. Because of RALs and associated check cashing costs, some estimates put the costs of access to EITC refunds at 7 cents on the dollar.⁶ In 2005, tax filers paid \$960 million in RAL fees, in addition to another \$100 million in so called “document fees.”⁷ According to the IRS, 83% of households applying for RALs in 2005 had incomes of \$35,000 or less and about 60% of EITC filers are also users of RALs.

EITC in Los Angeles County

EITC Trends

Of the nearly 4 million tax returns filed by Los Angeles County residents every year, about 1 in 5 claim EITC. In tax year 2006, just over 750,000 taxpayers in the county received EITC, providing approximately \$1.5 billion back to the community, at an average of almost \$2,000 per person. From 1997 to 2005, the number of taxpayers claiming EITC fluctuated between 760,000 to 810,000 and has been on the decline over the last few years. Over this same time period, however, the proportion of all tax returns with EITC remained relatively constant around 20% to 21%, which is higher than the national average of 17% but consistent with other urban areas across the nation.

EITC Trends in Los Angeles County, 1997-2005

Tax Year	EITC Returns	% of All Returns EITC	Total of EITC	Average EITC
1997	766,043	22.0%	\$1,225,129,737	\$1,599.30
1998	762,781	21.3%	\$1,279,540,919	\$1,677.47
1999	760,792	20.8%	\$1,314,370,366	\$1,727.63
2000	761,220	20.4%	\$1,309,495,583	\$1,720.26
2001	759,677	20.1%	\$1,334,796,006	\$1,757.06
2002	809,632	21.4%	\$1,471,133,414	\$1,817.04
2003	803,881	21.3%	\$1,464,361,698	\$1,821.62
2004	793,119	20.9%	\$1,469,453,578	\$1,852.75
2005	791,533	20.2%	\$1,502,134,940	\$1,897.75

Source: Authors' calculations of IRS data

EITC clearly provides an important income support to hundreds of thousands of low-income households and brings in needed resources to Los Angeles County communities, especially when coupled with other

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income supports. For example, about 30% of EITC recipients also receive the Child Tax Credit in Los Angeles County. However, there are still probably millions of dollars left on the table because not everybody who is eligible for EITC claims it. If we assume that 15% percent of taxpayers who are eligible for EITC do not claim it, Los Angeles County is missing out on approximately \$250 million in EITC funds every year.⁸

As we might suspect given the segregation of neighborhoods by income in Los Angeles, EITC is highly concentrated in certain areas of the region. The top 20 zip codes for EITC returns are in the south and eastern part of the City of Los Angeles and Los Angeles County, with one (93550) in the Antelope Valley. Together, these 20 zip codes account for a quarter of EITC returns filed in the county. In fact, in several of these areas nearly half of taxpayers claim EITC.

Top 20 EITC Zip Codes in Los Angeles County, 2004

Rank	Zip Code	City/Community	EITC Returns	% of Returns EITC	Total Amount of EITC
1	90011	Los Angeles/Vernon Central	12,495	46%	\$28,632,322
2	91331	Los Angeles/Pacoima	11,495	33%	\$23,204,459
3	90805	Long Beach	10,813	33%	\$22,349,104
4	90280	South Gate	10,768	33%	\$21,617,699
5	90250	Hawthorne	9,173	29%	\$17,791,067
6	90003	Los Angeles/South LA	9,165	49%	\$20,951,373
7	90044	Los Angeles/South LA	8,833	46%	\$19,636,676
8	90650	Norwalk	8,679	22%	\$16,002,077
9	90037	Los Angeles/South LA	8,476	48%	\$18,529,438
10	90262	Lynwood	8,329	37%	\$17,890,577
11	91706	Baldwin Park	7,902	29%	\$15,272,182
12	90026	Los Angeles/Central LA	7,606	28%	\$13,365,109
13	90006	Los Angeles/Mid City	7,587	43%	\$14,305,383
14	93550	Palmdale	7,307	32%	\$15,593,751
15	91342	Los Angeles/Sylmar	7,263	23%	\$13,901,539
16	90255	Huntington Park	7,245	36%	\$14,990,558
17	90022	East Los Angeles	7,233	34%	\$14,730,177
18	90004	Los Angeles/Mid City	7,100	30%	\$12,670,191
19	91402	Los Angeles/Van Nuys	7,051	33%	\$14,190,971
20	90019	Los Angeles/Mid City	6,866	28%	\$12,361,914

Source: Authors' calculations of IRS data

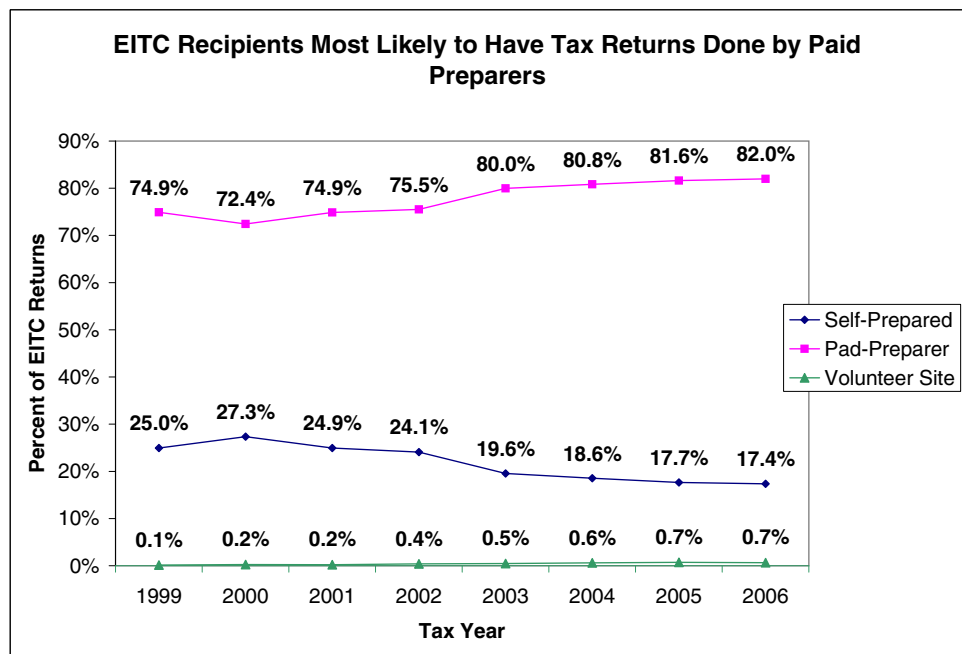
Tax Preparation Trends

The vast majority of households in Los Angeles County pay to have their taxes done, rather than going to a volunteer preparer or doing the taxes themselves. EITC recipients are even more likely to have taxes done by paid preparers (82% for EITC recipients, 73% for all taxpayers). Of EITC returns, the proportion done by paid preparers has risen from around 75% in 1999 to 82% in 2006, while self-prepared returns have declined from 25% to 17%. The percentage of returns prepared for free by volunteers – which include sites run through the IRS's Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs⁹ – has risen slightly from 0.1% in 1999 to 0.7% in 2006. This upward trend is consistent with national trends but still well below the national average of 1.8% of EITC filers who have their returns done at volunteer sites.¹⁰

Did you know?

Los Angeles County is missing out on approximately \$250 million in EITC funds every year.

There were about 170 free tax preparation sites in Los Angeles County last year, helping about 30,000 taxpayers prepare and file their returns and accounting for about \$7 million in EITC refunds.¹¹ United Way is the lead in the Greater Los Angeles EITC Campaign Partnership, which conducts marketing through a network of public, private and nonprofit partners (e.g. public agencies such as the L.A. County Department of Social Services and the Metropolitan Transportation Authority) to let people know they may be eligible for EITC and about free tax preparation sites. It is estimated that approximately 2.8 million people received or viewed outreach materials on EITC and VITA through the Partnership in 2006.



Source: Authors' calculations of IRS data

Refund Anticipation Loans (RAL) Trends

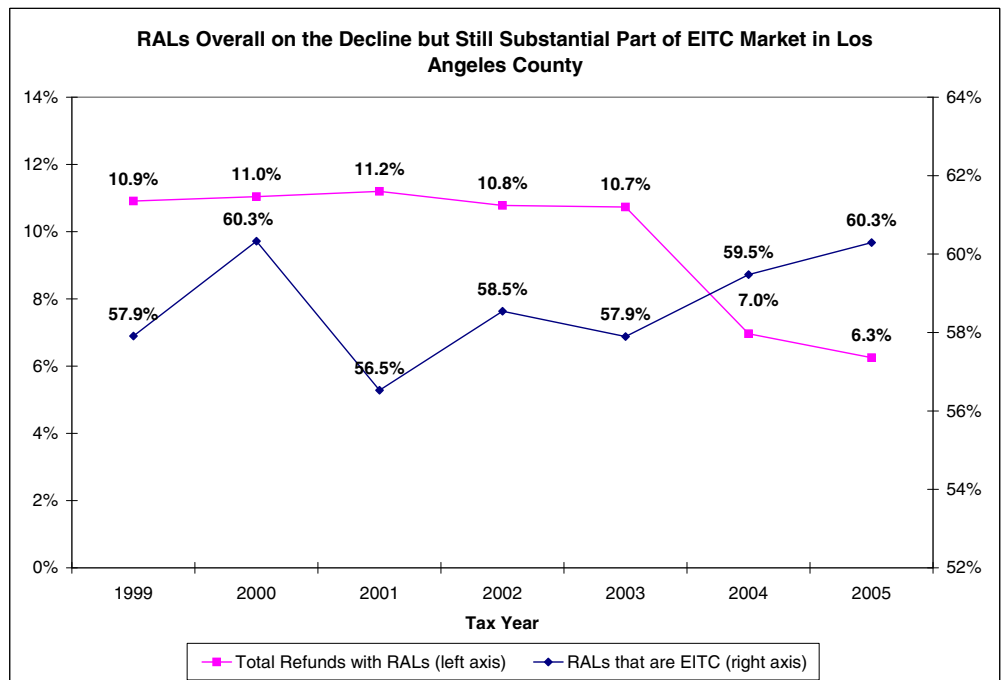
Data provided by the IRS show that the percentage of total tax refunds that include RALs in Los Angeles County has dropped from 11% in 2000 to 6% in 2005. This could be attributed to several factors, including the faster access to refunds by using electronic filing and direct deposit, mass marketing efforts by community organizations to educate tax filers on the high cost of using RALs, and legal actions brought against major tax filing corporations by consumer groups and local governments. These actions have also compelled some financial institutions to revisit their practices with respect to RALs. For example, in 2007 HSBC, the main banking partner of H&R Block in financing RALs, announced that it would stop issuing RALs during the pre-tax season in 2008.¹²

Despite the overall decline in RALs, they have maintained a stronghold in the EITC market. From 1999 to 2003, about a quarter of EITC claimants in Los Angeles County took out RALs, compared to just 11% of all taxpayers over the same time period. Consistent with overall trends, the percentage of EITC filers who got RALs dropped in 2004 and 2005 to about 16%, which is still double the overall rate. Even more telling is that the proportion of

Did you know?

EITC claimants make up about 1 in 5 of all taxpayers in Los Angeles County but almost 2 out of 3 taxpayers who purchase high-cost Refund Anticipation Loans from commercial tax preparers are EITC claimants.

RALs in Los Angeles County that were issued to people claiming EITC has been between 57% to 61% and rising over the past few years. If we assume an average cost of \$200 per RAL, EITC claimants spent an estimated \$22.6 million in RALs in the 2005 tax year.¹³



Source: Authors' calculations of IRS data

Implications and Policy Options

The Earned Income Tax Credit can be an important tool for helping lift people out of poverty in Los Angeles County. But, with millions of dollars still spent on RALs and extremely low levels of usage of VITA sites, there is still much work to be done in communicating to potential recipients and linking them to other benefits such as free tax preparation and other asset building opportunities. Here are several recommendations to help increase EITC usage across the county.

Promote and support outreach and VITAs

Coalitions can increase EITC uptake and avoidance of RALs by promoting the use of free tax preparation sites to low-income households. With less than 1% of taxpayers in Los Angeles County using volunteer tax preparers, there are potentially millions of dollars that could be saved by taxpayers in tax preparation and RAL fees. The existence of RALs as a financial tool may be justified on the grounds that it can provide a valuable service to families and individuals who are in urgent need of cash, but the fact that it is so heavily a part of the EITC market is very disturbing. RALs depreciate the value and effectiveness of this important poverty reduction strategy as they increase the cost of access to this public benefit program. Although RALs were a relatively reasonable option before speedy electronic filing, today, the IRS can refund e-filers' money in 10 days, and state income refunds can take half that time. Some credit

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unions even provide alternative, low-cost RALs in partnership with VITA sites that cost a fraction of RALs at commercial providers.¹⁴ Supporting VITAs and outreach campaigns requires financial and human resources, especially when it comes to building the quality of tax preparation sites so they can adequately compete with commercial providers. Cities such as Chicago and New York provide more than \$1 million to support EITC and VITA outreach, and cities around the country are becoming increasingly focused on building quality at VITA sites.¹⁵

Explore Viability of State and Local EITCs

The success of the Federal EITC program has created interest in state and even city governments looking to develop their own tax credit programs as a policy instrument to help the working poor. As of 2007, there were 23 states with their own EITC program, out of 42 states which levy income tax.¹⁶ Generally, states either provide a refundable EITC, where households receive a refund minus any tax liabilities; or a non-refundable EITC that provides just enough relief to offset any tax liability. By requiring EITC eligibility to be linked with the federal program, local governments can create incentives, which will raise awareness of the federal EITC and encourage more people to apply, maximizing the local share of refunds. California is not among the states that have an additional EITC, given the recent budget shortfalls in the state, but San Francisco has a local program, called the Working Families Credit which provides a match to EITC. In 2005, working families in San Francisco qualified for a match of 10% of EITC, with nearly 10,000 taxpaying families receiving an average of \$220 extra from the local program.¹⁷

Promote the Advance EITC to Employers

The Advance EITC (AEITC) allows families with at least one child who expect to receive EITC to receive an advanced portion of this refund via their paychecks, and claim the remaining, when they file their taxes. Employers provide advance payments from withheld income, Social Security and Medicare taxes, allowing workers to receive these advancements in their paychecks throughout the year, effectively increasing their take home income.¹⁸ Eligible workers can claim up to 60% of their EITC in advance in their paychecks during the year, and the remaining 40% is provided in their tax return refund. Recent California legislation (AB650, 2007-8) requires all employers in the state who provide unemployment insurance to notify employees about EITC within one week of giving them their W-2s, and employers must provide the Advance EITC to any employee who requests it.¹⁹ More outreach to both employees and employers could increase the utilization of AEITC significantly.

Link EITC and VITA Outreach to Other Income and Asset-Building Strategies

In order to successfully move people and families down the path to financial stability and independence, efforts to increase the use of EITC and free tax preparation need to be linked to other income and asset-building strategies such as financial education, workforce development, savings such as Individual Development Accounts, and asset purchase

Did you know?

Of EITC returns in Los Angeles County, the proportion done by paid preparers has risen from around 75% in 1999 to 82% in 2006, while self prepared returns have declined from 25% to 17%. Less than 1% of EITC returns are done by volunteer preparers.

and preservation. Building the capacity of VITA sites to operate year-round and provide a full set of services and referrals will increase the ability of taxpayers to access these services and thus avoid risky or predatory providers. Federal policy also needs to address restrictions in welfare (TANF) policy that currently limits the ability of TANF recipients to save their EITC dollars by subjecting these refunds to property limit calculations. This discourages many households from saving their EITC refunds in bank accounts as it could potentially move poor families out of eligibility for TANF. Coordination and integration of these various income and asset-building strategies and policies can help residents move and stay out of poverty over the long term.

Acknowledgements

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<http://www.greaterlaeitc.org>

Endnotes

¹ Holt, Steve, February 2006, *The Earned Income Tax Credit at 30: What We Know*. The Brookings Institution, http://www.brookings.edu/~media/Files/rc/reports/2006/02childrenfamilies_holt/20060209_Holt.pdf

² For more information on eligibility and credit amounts broken down by family size and income, see IRS Publication 596 and <http://www.irs.gov/individuals/article/0,,id=130102,00.html>.

³ Hotz, V. Joseph and John Karl Scholz, January 2001, *The Earned Income Tax Credit*. National Bureau of Economic Research, NBER Working Paper No. 8078, <http://papers.nber.org/papers/w8078>.

⁴ Kneebone, Elizabeth, April 2007, *A Local Ladder for Low-Income Workers: Recent Trends in the Earned Income Tax Credit*. The Brookings Institution, <http://www3.brookings.edu/metro/pubs/200704eitc.pdf>

⁵ Tax Return Interactive Website User Guide and Data Dictionary, Brookings Institution, <http://www.brookings.edu/metro/EITC/EITC-Data.aspx>.

⁶ Audetat, A., B. Myers, S. Cocciarelli, and Y. McGill, 2004, *Building a Better Refund Anticipation Loan: Options for VITA Sites*. Center for Responsible Lending, <http://www.responsiblelending.org/pdfs/RALs-BetterRAL-1104.pdf>

⁷ Wu, Chi Chu and Jean Ann Fox, 2007, *One Step Forward, One Step Back: Progress Seen in Efforts against High Priced Refund Anticipation Loans, but More Abuse Products Introduced*. National Consumer Law Center and Consumer Federation of America, http://www.consumerlaw.org/issues/refund_anticipation/content/2007_RAL_Report.pdf

⁸ This estimate is calculated by multiplying 128,000 (the estimated number of EITC eligible taxpayers who did not claim it in 2006 if we assume an 85% uptake rate) by the average size EITC (\$1,968).

⁹ For more information on these programs, see: <http://www.irs.gov/individuals/article/0,,id=107626,00.html>

¹⁰ Kneebone, April 2007.

¹¹ Data provided by IRS. Of the 170 sites, 88 were VITA sites and 82 were TCE sites run by AARP.

¹² See for example, <http://seekingalpha.com/article/29873-hsbc-to-discontinue-off-season-tax-refund-lending>

¹³ There were 113,352 RALs taken out by EITC claimants in Los Angeles County in 2005, according to the IRS. The average cost estimate of \$200 (which includes tax preparation fees) is somewhat conservative but based on both local and national research. See, for example, Audeat et al., 2004.

¹⁴ See for example, the Alternatives Federal Credit Union's Refund Express Loan, which on a typical \$2,000 refund costs the taxpayer about \$200 less than a traditional RAL. <http://www.alternatives.org/refundexpress.html>

¹⁵ Brown, Amy, April 2007, *Quality in EITC Campaigns: Results from the 2007 Tax Season*. Prepared for the Annie E. Casey Foundation. <http://www.unitedwaytucson.org/pages/eitcdocuments.php>

¹⁶ Levitis, Jason and Jeremy Koulish, October 2007, *A Majority of States with Income Taxes have Enacted State Earned Income Tax Credits*. Center on Budget and Policy Priorities. <http://www.cbpp.org/10-5-07sfp.pdf>

¹⁷ Flacke, Tim and Tiana Wertheim, May 2006, *Delivering a Local EITC: Lessons from the San Francisco Working Families Credit*. Brookings Institution, <http://www.brookings.edu>.

¹⁸ More information on AEITC for employers is available at <http://www.irs.gov/localcontacts/article/0,,id=177825,00.html> and in IRS Publication 596.

¹⁹ AB650 was signed by the governor and chaptered on October 13, 2007. The text of the bill is available at: http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_0601-0650/ab_650_bill_20071013_chaptered.pdf