

Paying the Price? Low-Income Parents and the Use of Paid Tax Preparers

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The Earned Income Tax Credit (EITC), which is administered through the federal income tax system, is the largest cash assistance program for low-income families.¹ The EITC provides up to \$4,200 a year for working families with two or more children—less for families with fewer children. The refundable EITC first offsets taxes owed and then provides additional income to families through a tax refund.² In 2002, the EITC lifted around 4.9 million people out of poverty (Llobrera and Zahradnik 2004).

Policymakers designed the EITC to encourage work by subsidizing people's wages. Indeed, some research suggests that this goal has been met among single mothers (Eissa and Hoynes 1998; Meyer and Rosenbaum 1999). For the EITC to meet this goal, however, eligible people must know about the credit.

Among low-income parents, Ross Phillips (2001) found marked inequities in who knew about the EITC among various racial groups. Only 32 percent of low-income Hispanic parents knew about the EITC in 1998, many fewer than their peers of other races and ethnicities. This variation in awareness raises questions about how low-income families, many of whom are not required to file a tax return, learn about the credit. One avenue might be through a caseworker at a welfare office. However, only a small share of low-income parents interacts with a welfare office. Another

avenue could be through filing a tax return either individually or with the help of a paid preparer.

Many low-income families need assistance preparing their tax returns. Data from the IRS indicate that almost all filers who receive assistance receive it from a paid preparer, including 98 percent of families with incomes below \$30,000.³ This fact raises important policy concerns. First, mere use of a paid preparer and secondary services such as refund anticipation loans⁴ erode the value of credits such as the EITC for low-income families (Berube et al. 2002). Second, while use of a preparer could enhance knowledge of such key tax provisions as the EITC, it could also reduce knowledge if the preparer doesn't share information or the client doesn't ask—limiting the credit's effectiveness at creating incentives to work. On the other hand, low-income families that use a paid preparer may reap benefits because professional preparers should know more about the tax benefits available to their clients. However, some apparently eligible families that use paid preparers do not claim the EITC (GAO 2003).

This brief uses the 2002 National Survey of America's Families to document the use of paid preparers by low-income parents, broken down by race and education level. It also examines the relationship between using a paid preparer and

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whether a parent knows about and receives the EITC.

Low-income parents are more likely than other parents to rely on outside help to prepare their return. This help may come with significant costs that offset tax assistance targeted at low-income families. However, low-income parents who know about the EITC and receive help are more likely to receive the EITC than their peers who prepare their returns independently.

The Earned Income Tax Credit

The EITC provides a wage subsidy of 40 cents for each dollar a family with two or more children earns until their income reaches \$10,510 (in 2003). The EITC has undergone several expansions, the most recent of which allows married parents to receive the EITC at slightly higher incomes than unmarried parents.⁵ A single parent with two or more children receives the maximum EITC subsidy of \$4,200 if she earns between \$10,510 and \$13,730; married parents can receive the maximum subsidy until their earnings reach \$14,730. After that, the subsidy decreases by about 21 cents for each additional dollar earned until no more credit is available. Single parents exhaust the credit once their income reaches \$33,692; married couples exhaust the credit once their income reaches \$34,692.⁶

Data and Methods

The 2002 National Survey for America's Families (NSAF) provides an excellent data source for understanding the use of paid preparers by low-income parents and their knowledge of the EITC. It is the first nationally representative dataset to collect a wide range of demographic information and ask whether a community service group or paid preparer helped the family complete its tax return.⁷ The 2002 NSAF also probes respondents about their knowledge of the EITC and whether they received the credit. Because the EITC targets benefits toward low-income working fam-

ilies, this analysis focuses exclusively on those with incomes less than twice the federal poverty level (FPL). For a single parent with two children, the maximum credit nears the poverty level (\$14,824) and phases out after income reaches 200 percent of FPL. For married couples with two children, the credit maximum is available at incomes below the poverty level (\$18,660) and phases out closer to 200 percent of FPL.

Who Knows About the EITC?

The majority of low-income parents (58.1 percent) know about the EITC (table 1). Very low income parents (those with incomes below 50 percent of FPL) and those with incomes between 50 and 100 percent of FPL report significantly less knowledge of the EITC (52.2 percent and 56.8 percent, respectively) than those with incomes above 150 percent of FPL (about 60 percent). Parents in the lower income groups typically qualify for at least a small EITC. Moving up the income ladder for these parents would generally lead to larger EITCs, since they are probably not on the brink of phasing out of the EITC, as parents at higher incomes are.

Only a small portion (27.1 percent) of low-income Hispanic parents know about the EITC—significantly less than their peers of other races and ethnicities. A smaller portion of black, non-Hispanic parents report knowing about the EITC than other non-Hispanic parents, but the gap is much smaller (68.0 percent versus 73.5 percent). Also, parents who did not complete high school report significantly less knowledge than parents who completed college.

This disparity in who knows about the EITC magnifies when analyzing who receives the EITC.⁸ Overall, 38.6 percent of low-income parents report receiving the EITC. Strikingly, only 14.6 percent of Hispanic parents report receiving the EITC compared with 44.3 percent of black, non-Hispanic parents and 51.5 percent of other non-Hispanic parents.

The majority of low-income parents (58.1 percent) know about the EITC.

TABLE 1. Low-Income Parents' Knowledge and Receipt of the Earned Income Tax Credit, or EITC (percent)

	Heard of the EITC	Received the EITC
All	58.1	38.6
Family income as percent of federal poverty level		
Less than 50%	52.2*	28.7*
50%–100%	56.8*	38.0
100%–150%	58.9	42.7*
150%–200% ^a	61.4	40.4
Race		
Hispanic	27.1*	14.6*
Black, non-Hispanic	68.0*	44.3*
Other ^a	73.5	51.5
Education level		
Less than high school	39.8*	20.4
High school graduate	65.0	47.1*
Some college	71.4*	50.9*
Completed college ^a	64.8	37.3

Source: Author's tabulations using the 2002 National Survey of America's Families.

a. Base category for statistical comparisons.

* Significantly different from comparison group at the 0.05 level.

Use of Paid Preparers

Overall, 66.8 percent of low-income parents who are required to file a tax return receive help preparing their return. Hispanic and black, non-Hispanic parents report get-

ting help with their return significantly more often than other parents (table 2).

Low-income parents who have not completed high school receive help preparing their tax return more often than those who have completed college (73.4 percent

TABLE 2. Characteristics of Low-Income Parents Who Received Help with Their Tax Return (percent)

	Low-income families
All	66.8
Race	
Hispanic	71.5*
Black, non-Hispanic	73.2*
Other ^a	61.8
Education level	
Less than high school	73.4*
High school graduate	70.2*
Some college	57.6
Completed college ^a	52.6

Source: Author's tabulations using the 2002 National Survey of America's Families.

Notes: Includes only those parents who filed a tax return and were primarily responsible or shared primary responsibility for collecting information for their tax return.

a. Base category for statistical comparisons.

* Significantly different from comparison group at the 0.05 level.

versus 52.6 percent). Even high school graduates who have not attended college receive significantly more help (70.2 percent) preparing their returns than those who completed college. As we might expect, the complexity associated with filing a return presents a greater challenge for low-income parents with limited education than for those with more education.

Knowledge of the EITC and Connection to Paid Tax Preparation

Some groups that report less knowledge of the EITC also report greater reliance on outside help to prepare their returns. This could mean that taxpayers with less knowl-

edge of the tax system are more likely to use paid preparers, or that using a paid preparer contributes to less knowledge of the tax system by the taxpayer, or both. On the other hand, using a paid preparer may help guarantee that with or without knowledge, parents receive the many benefits for which they qualify, including the EITC.

Among low-income parents, receiving help with a tax return is not associated one way or the other with whether a person has heard of the EITC, except among select subgroups (table 3). One subgroup is parents with incomes between 100 and 200 percent of FPL: among these parents, those who do not receive help preparing their taxes are more likely to have heard about the EITC than those who do receive

TABLE 3. Interaction between Use of Paid Preparer, Knowledge of EITC, and EITC Receipt for Low-Income Parents Required to File Tax Returns

	Heard of EITC		Ever Received EITC (of parents who have heard of EITC)	
	Received help	No help	Received help	No help
All	69.3	72.2	79.1	70.3*
Income				
≤ poverty level	68.3	67.8	78.6	68.5*
100%–200% of poverty level	69.8	74.5*	79.4	71.2*
Race				
Hispanic	36.5	40.2	72.2	59.4*
Black, Non-Hispanic	80.3	79.1	81.0	69.8*
Other	82.9	81.1	80.2	71.7*
Education level				
Less than high school	50.8	47.4	73.9	56.8*
High school graduate	76.3	74.7	82.0	76.0*
Some college	80.0	83.1	81.3	70.7*
Completed college	62.4	79.5*	62.4	64.0
AFDC/TANF use				
Current	76.3	68.7*	82.2	70.3
Past	89.2	92.1	92.3	88.4
Never	63.2	67.6	73.5	64.3*
Food stamp use				
Current	77.1	76.0	86.7	73.6*
Past	81.9	84.4	88.4	86.4
Never	55.9	63.1	63.3	54.8*

Source: Author's tabulations using the 2002 National Survey of America's Families.

Notes: Includes only those parents who filed a tax return and were primarily responsible or shared primary responsibility for collecting information for their tax return.

* Difference between those who received help filing their returns and those who did not significant at the 0.05 level.

help, in contrast to parents with incomes below the FPL for whom there is no significant difference between those who receive help and those who don't. Another subgroup is college graduates. Again, within this group, those who do not receive help preparing their taxes report significantly more knowledge of the EITC than those who do receive help.

As noted earlier, this does not suggest that preparers fail to provide adequate information about the EITC to their clients, since we do not know who had heard of the EITC before going to a tax preparer. Possibly, those who choose to go to a preparer are those who start out knowing much less about taxes in general, including the EITC. A smaller proportion of them could end up knowing about the EITC than in the group that started out more knowledgeable, even if the first group's level of knowledge improved somewhat after receiving help with their return.

Among low-income parents required to file tax returns, over two-thirds of welfare recipients (both current and former) know about the EITC, and three-quarters of food stamp recipients know about the EITC. This is true regardless of whether parents receive help preparing their return. Though levels of knowledge of the EITC are high for all TANF recipients, current TANF recipients who receive help with their return are significantly more likely to know about the EITC than current TANF recipients who do not receive help preparing their return. This difference is in the opposite direction from the differences cited above. It could mean that among welfare recipients, the group that uses a preparer starts out more knowledgeable, or that tax preparers enhance the knowledge of their clients who are welfare recipients, or both.

Receipt of the EITC and Connection to Paid Tax Preparation

Among parents who have heard about the EITC, a significantly larger proportion of those who have help preparing their return report receiving the EITC than of those

who do not have help. Nearly 80 percent of low-income parents who know about the EITC and receive assistance with their return report receiving the EITC, compared with 70 percent of those who do not get help.

This greater likelihood of receiving the EITC if a taxpayer gets help holds true for most subgroups of low-income parents. Across racial and ethnic groups, significantly larger portions of people who get help preparing their return receive the EITC than those who do not get help. Low-income parents with less than a college degree report receiving the EITC in larger proportions if they get help preparing their return than if they prepare their returns on their own. However, for low-income college graduates, receipt of the EITC does not vary based on whether they receive help with their tax return. Receipt patterns of current food stamp recipients and low-income parents who have never received food stamps also suggest that those who receive help preparing their return are more likely to receive the EITC.

Conclusion

Knowledge of the EITC among low-income parents is high—particularly for parents with incomes above 50 percent of FPL. While the data are hard to interpret, the use of paid tax preparers is not associated with an increase in knowledge except among current welfare recipients. Possibly, current welfare recipients with limited earnings encounter the tax system for the first time. This group of people may be most assisted by the additional knowledge a paid preparer can provide—and may also be aided by IRS publicity efforts. Additional efforts aimed at publicizing the EITC may also be successful targeting Hispanic communities, whose members report the least knowledge of the EITC.

At the same time, use of paid tax preparers is associated with greater receipt of the EITC among those who are knowledgeable about it, across all racial and ethnic groups, all income groups, and most educational groups (except the most educated).

Receiving help with a tax return is not associated one way or the other with whether a low-income parent has heard of the EITC.

Thus, the considerable amount of assistance that low-income parents receive in filing their tax returns may be a good thing. Concerns that those using paid preparers are less likely to know about the EITC seem misplaced.

On the other hand, the high reliance on outside help to complete a tax return could be problematic. Low-income parents who turn to paid preparers receive less net benefit from the EITC because they pay to have their return prepared. In the Washington, D.C., area, tax return preparation costs approximately \$95 (Berube et al. 2002). Also, low-income parents who use paid preparers may use other costly services such as rapid refunds or refund anticipation loans.

The IRS could pursue several options to ensure the maximum amount of EITC benefit reaches the intended recipient. For example, it could reduce the incentive to use a paid preparer to access a refund anticipation loan by providing faster refunds—though this may trade off with fraud protection. It could expand existing free preparation services, particularly in low-income neighborhoods. Further simplifications to the tax code could also be promoted.

Simplification that focuses on the definition of qualifying children would help. This definition receives frequent attention as a cause of tax confusion (Carasso, Steuerle, and Rohaly 2003). The tax maze varies the rules regarding whether a child qualifies for each tax credit or exemption. The Working Families Tax Relief Act of 2004 considerably simplified the definition of a child in many tax programs, but retained differences in ages for who qualifies for particular programs. For example, only children under age 19 or students under age 24 qualify as children when calculating the EITC and dependent exemptions. Children must be under age 17 to qualify parents for a child tax credit of up to \$1,000. Up to \$3,000 of dependent care expenses can be offset for children under age 13 with the child and dependent care

tax credit. The number of children that can count toward each credit and exemption also varies from two to unlimited. These rules can be confusing and may prompt individuals who qualify for these various credits to seek assistance preparing their return.

Trade-offs inherently exist between providing additional support to low-income families through the tax system and complexity in filing a return. One key element to allowing the EITC to act as a work incentive and reduce complexity is to make rules associated with the EITC transparent. Persistent disparities in who knows about the EITC warrant further attention.

Notes

1. Preliminary estimates of the 2002 nonadministrative costs of the EITC total \$38.7 billion (IRS 2004); combined state and federal spending on cash assistance in Temporary Assistance for Needy Families (TANF) totaled \$14.6 billion (HHS 2002).
2. Some tax credits are nonrefundable and can only be used to offset taxes owed. These credits are of limited value to low-income families, who likely owe little or no personal income tax.
3. Tabulations from the 1999 Statistics of Income file.
4. Refund anticipation loans allow families to receive their anticipated EITC very quickly. These loans are often subject to high interest costs.
5. The 2001 Economic Growth and Tax Relief Reconciliation Act increased the income point at which the EITC begins to phase out by \$1,000 starting in 2002, \$2,000 starting in 2005, and \$3,000 starting in 2008. The legislation is set to expire in 2011, at which point the EITC will return to phasing out at the same point for both single and married parents.
6. Some low-income adults with no children can also receive a small EITC. This brief's analysis is limited to parents.
7. For more information on the NSAF, see Natalie Abi-Habib, Adam Safir, and Tim Triplett, *NSAF Survey Methods and Data Reliability* (Washington, DC: The Urban Institute, 2004), NSAF Methodology Report 1.
8. Reported receipt in the NSAF is predicated on knowing about the EITC, so more people may be receiving the EITC than report receiving it in the NSAF.

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This series presents findings from the 1997, 1999, and 2002 rounds of the National Survey of America's Families (NSAF). Information on more than 100,000 people was gathered in each round from more than 42,000 households with and without telephones that are representative of the nation as a whole and of 13 selected states (Alabama, California, Colorado, Florida, Massachusetts, Michigan, Minnesota, Mississippi, New Jersey, New York, Texas, Washington, and Wisconsin). As in all surveys, the data are subject to sampling variability and other sources of error. Additional information on the NSAF can be obtained at <http://newfederalism.urban.org>.

The NSAF is part of *Assessing the New Federalism*, a multiyear project to monitor and assess the devolution of social programs from the federal to the state and local levels. Olivia A. Golden is the project director. The project analyzes changes in income support, social services, and health programs. In collaboration with Child Trends, the project studies child and family well-being.

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