

MAY 2023

Benefits of Free and Simplified Tax Filing for Families of Color

How the tax filing burden locks families of color out of tax benefits

INTRODUCTION

America's tax filing system is expensive and complicated. Complexities in the tax code lead to two areas that harm taxpayers overall, with a disparate impact for families of color:

- 1) Because of the time and money cost of filing taxes, millions of low-income families and families of color don't or can't file taxes, effectively becoming locked out of the valuable tax credits they've earned;*
- 2) The tax prep industry makes billions of dollars off of Americans every year, siphoning off benefits that are meant for low-income families.*

The IRS has the data needed to create a free and simplified tax filing tool, which would take the cost and headache out of tax filing for millions. By creating a system that dramatically increases access to free tax filing, the IRS has the power to ensure more households of color get the refunds and credits they deserve.

MANY FAMILIES OF COLOR ARE LOCKED OUT OF VALUABLE TAX BENEFITS

The racial wealth divide is rooted in slavery, and perpetuated by policies like redlining, discrimination in jobs and education, and unequal access to asset-building opportunities. Today the racial wealth divide is staggering: for every \$100 in wealth for white families, Black families own just \$12 and Latinx families own \$21.

Of course, eliminating the wealth divide will require fundamental changes in almost every area of our economy. Policies that increase

incomes among hardworking families of color by helping them keep more of the money they earn is one critical piece of the puzzle. The Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) are powerful poverty-reducing programs that could move us in the right direction. Together, these programs carry the promise of narrowing the divide by providing outside benefits to those communities of color who have faced the highest and hardest barriers to economic security. Because those programs are built into our tax code, their ability to deliver on that promise depends on people's access to the tax code. **The burdensome filing process**

coupled with the high cost of tax prep services makes it harder for many low-income families of color to access these tax credits, and could actually work to widen racial disparities in poverty.

By design and practice, many who have the hardest time getting tax credits are those who need them the most. Right now, roughly one in five eligible families don't get their EITC because it's too hard or expensive to file taxes. The limited research that is available tells us that people of color are already among those at the highest risk of missing out on the EITC, specifically people who:

- 1) Live in Latinx communities;
- 2) Are Native Americans;
- 3) Participate in food stamp programs;
- 4) Have a language other than English as their first language.

The same is true for the CTC: national surveys consistently found that Latinx and Black families were among the least likely to receive the expanded CTC they were eligible for in 2021. Another study reiterated this point by showing that Latinx, American Indian/Alaska Native, Native Hawaiian/Pacific Islander, multiracial, and lowest-income families were the least likely to receive monthly CTC payments in 2021.

“One in five eligible families don't get their EITC because it's too hard or expensive to file taxes.”

Internal Revenue Service, 2019

One major reason takeup in these programs is low is that the families and individuals are required to perform the right combination of tasks at the right time to unlock them – in this

case, filing a tax return. The act of filing taxes is burdensome: especially for low-income families, immigrants, and people with language barriers. So these families remain largely unconnected to the tax system, locking them out of thousands of dollars in benefits.

THE TAX CODE IS RACE-NEUTRAL ON ITS FACE, BUT ITS IMPACTS AREN'T

Nearly every part of the tax code interacts with race and ethnicity in ways that aren't written into the code but which have very real racially disparate consequences. Some policies, like the EITC and CTC carry the promise of outsized impacts for households of color, but the lion's share of tax policies actually create significant disadvantages to people of color compared to white people – from marriage bonuses to preferential tax treatment for capital gains, homeownership, and retirement savings.

Black taxpayers are audited at a higher rate than other taxpayers. Recent research from Stanford Institute for Economic Policy Research found that Black taxpayers are audited at 2.9 to 4.7 times the rate of non-Black taxpayers – even though the process is entirely run by an algorithm. The disparity is mainly due to increased audits for the low- and moderate-income taxpayers who claim the EITC.

Tax benefits not only provide considerable financial resources, they also engender faith in government and a feeling of community. When the CTC was expanded in 2021, survey data showed recipients felt like the government cared about their family's health and wellbeing and was responsive to the needs of their community – findings that were more pronounced for Black and Latinx

respondents. We know how CTC and EITC have benefited the wellbeing of households, and by allowing for Black and Latinx households to fall through the cracks, we are only serving to perpetuate the disparities that underlie our society.

“Despite race-blind audit selection, Black taxpayers are audited at 2.9 to 4.7 times the rate of non-Black taxpayers.”

Stanford Institute for Economic Policy Research

THE BURDEN OF TAX FILING ENRICHES TAX PREP COMPANIES TO THE DETRIMENT OF TAXPAYERS

For those who file taxes – as most Americans are required to – it is nearly impossible to do so without spending significant time and money simply to comply with the law. **The average taxpayer spends \$250 and 13 hours filing taxes each year – and that money goes right into paid tax prep companies’ profits.** Even though the IRS ostensibly offers free filing through a public-private partnership with the tax prep industry, that program is broken. The tax prep companies have bent over backwards to push people toward paid tax filing, so only 3% of eligible tax filers get free tax filing today.

Each year, 87 million taxpayers who should qualify for free filing lose as much as \$13 billion of their refunds to tax prep companies for something that ought to be free. To protect their profits, the largest tax preparation companies have spent tens of millions lobbying Congress to kill efforts to provide Americans with a free and simplified public tax filing option.

FREE AND SIMPLIFIED FILING WOULD MAKE TAX CREDITS MORE ACCESSIBLE

Recent analysis from Code for America found that 21 percent of filers could not provide earnings documentation required to file taxes. The fact is the IRS already has the data on most taxpayers’ incomes, but under the current system, taxpayers are required to fill out a tax return with data the IRS already has, and be penalized if they make a mistake. Americans should have a free and simplified option to do their taxes. The IRS has the data needed to create a free and simplified tax filing tool, which would eliminate the cost and time burden of tax filing for millions of U.S. residents – particularly those in communities of color who have the hardest time accessing the tax system now. **By creating a system that dramatically increases access to free tax filing, the IRS can ensure that more people of color get the crucial tax credits they have earned.**