

# **Coming Down: Fewer Refund Anticipation Loans, Lower Prices from Some Providers, But Quickie Tax Refund Loans Still Burden the Working Poor**

## **The NCLC/CFA 2008 Refund Anticipation Loan Report**

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### **EXECUTIVE SUMMARY**

Refund anticipation loans (RALs) are 1 to 2 week loans made by banks and facilitated by tax preparers, secured by the taxpayer's expected tax refund. RALs can carry triple digit APRs, and expose taxpayers to the risks of unpaid debt if their refunds do not arrive as expected.

This report contains the annual update on the RAL industry from the National Consumer Law Center and Consumer Federation of America. Some of the findings from this report include:

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The National Consumer Law Center is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, who represent low-income and elderly individuals on consumer issues.

Consumer Federation of America is a non-profit association of about 300 groups, with a combined membership of over 50 million people. CFA was founded in 1968 to advance consumers' interest through advocacy and education.

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- RAL volume declined from 2005 to 2006. Consumers took out approximately 9 million RALs during the 2006 tax-filing season compared to 9.6 million in 2005 and 12.4 million in 2004. Part of the 2006 decline is probably due to better reporting. In 2006, the IRS required tax preparers for the first time to separately report RALs versus non-loan refund anticipation check (RACs) products. Thus, prior data may have included RACs that were erroneously reported by tax preparers as RALs.
- The price of RALs has declined significantly for some of the biggest players in the industry, introducing new price competition. Both industry giant H&R Block and major RAL lender JP Morgan Chase have lowered their prices. The price of a RAL for the average refund of \$2,600 can range from \$58 to \$136. Thus, taxpayers should be advised to avoid RALs; but if they insist on getting one, they should shop around.
- The APRs for RALs can still range in the triple digits. H&R Block and JPMorgan Chase claim that their RALs carry an APR of 36%, but that calculation does not include the fee for the dummy bank account used to repay the RAL, which doubles the APR. Other tax preparers, such as Jackson Hewitt and Liberty Tax Service, continue to offer high cost RALs with APRs in the triple digits. The effective APR for RALs based on a 10-day loan period ranges from about 50% (for a loan of \$10,000) to nearly 500% (for a loan of \$300). The APR for a loan of a typical refund size of about \$2,600 can be from 83% to 194%.
- Consumers paid an estimated \$900 million in RAL fees in 2006 to get quick cash for their refunds – essentially borrowing their own money, and some at extremely high interest rates. This represents a decrease of 27% from 2004 to 2006, but is still a tremendous drain on the tax refunds of American taxpayers.
- In addition to RAL fees, consumers paid another estimated \$90 million in “document processing” or “application fees” in 2006. Since the major preparation chains do not charge this fee, except for potentially some Jackson Hewitt franchisees, we based this estimate on an assumption that about 25% of RAL borrowers are charged this fee.
- New protections took effect for military Service members. The Department of Defense issued regulations effective October 1, 2007, pursuant to the Military Lending Act, that ban RALs over 36% APR to Service members. Because this 36% APR cap is all-inclusive, most RALs exceed that cap given that the refund account fees and application fees must be included. H&R Block is the sole exception, with a “military RAL” that is truly 36% APR.
- During 2007, a number of government agencies took enforcement actions involving RALs. The U.S. Department of Justice sued five Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. The California Attorney General filed lawsuits against Jackson Hewitt and Liberty Tax Service over their promotion of RALs. Jackson Hewitt settled with the Attorney General, promising reforms of its practices and paying \$4 million in consumer refunds plus \$1 million in penalties and costs. The New Jersey Attorney General’s Office sued a local tax preparation chain, Malqui Corporation, for deceptive advertisement of RALs. The New York State Division of Human Rights sued both Jackson Hewitt and

Liberty Tax Service for discriminatory targeting of minorities for RALs, in violation of NY Human Rights Law.

- Another positive development in 2007 was the near total elimination of “pay stub” and “holiday” RALs. These were RALs made prior to the tax filing season, before taxpayers received their IRS Form W-2s and could file their returns. These RALs presented additional costs and risks to taxpayers. All three of the major RAL banks announced they would stop offering these loans. However, some fringe operators, such as payday lenders and used car dealers, may still offer pay stub RAL-like loans.
- H&R Block, through its own bank, is now offering a credit product to its tax clients, the Emerald Advance Line of Credit which carries an interest rate of 36% plus an annual fee of \$30, which is much less expensive than short-term fringe lending products such as payday or auto title loans. This loan, which is offered prior to tax filing season, is not explicitly tied to tax refunds, although we assume many borrowers will end up using their refunds to repay it, since the loan is due in full on February 15.
- The IRS has finally opened a rulemaking proceeding regarding potential RAL regulation. In January 2008, the IRS issued a request for comments regarding whether it should develop rules restricting the sharing of tax return information to market RALs, RACs, audit insurance and other financial products typically sold to low-income taxpayers. The IRS specifically asked for information about whether these products provide preparers with a financial incentive to inflate refund claims inappropriately. The IRS is accepting comments on the issue until April 7, 2008.
- Fringe operators, such as used car dealers and payday lenders, also offer tax preparation and RAL services to their customers. The problems with fringe providers engaged in tax preparation include the questionable quality of preparation and the inadequacy of privacy protection. H&R Block has quietly joined with payday lenders and other fringe financial service providers to provide tax preparation services and RALs through its TaxOne subsidiary. Car dealers are another type of business attracted to tax preparation. Florida-based Tax Refund Services Inc is a company that specializes in providing software and back office support to car dealers engaged in tax preparation.

## PART I. OVERVIEW AND NUMBERS

Refund anticipation loans (RALs) are loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs usually run for a duration of about 7-14 days (the difference between when the RAL is made and when it is repaid by deposit of the taxpayer's refund), fees for these loans can translate into triple digit Annual Percentage Rates (APRs) for certain high priced providers.

RALs drain hundreds of millions of dollars from the pockets of consumers and the U.S. Treasury. They target the working poor, especially those who receive the Earned Income Tax Credit (EITC), a refundable credit provided through the tax system and intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, providing nearly \$41.8 billion to 22 million families in 2006.<sup>1</sup>

This report updates the NCLC/CFA annual reports on the RAL industry and the drain caused by RALs from EITC benefits. Those interested in background information on the industry and regulation should refer to the first NCLC/CFA RAL Report published in January 2002.<sup>2</sup>

We have seen significant progress in the fight against RALs. The number of RALs has declined by about 27% from 2004 to 2006. The volume of RALs in 2006, the most recent year for which the IRS has data, was about 9 million, compared to 12.4 million in 2004.

The price of RALs has also declined significantly. H & R Block, the nation's largest tax preparation firm, cut its RAL prices to about 1% of the loan amount plus \$29.95 for the "dummy account" used to repay the loan. Another major RAL lender, JPMorgan Chase, dropped its prices to a similar level. Despite these prices cuts, RALs continue to drain hundreds of million of dollars from the pockets of American taxpayers, including EITC recipients.

Other notable progress in reforming RAL practices occurred in 2007. All of the major RAL banks announced they would stop making "pay stub" and "holiday" RALs. These were RALs made prior to the tax filing season, before taxpayers received their IRS Form W-2s and could file their returns. These RALs presented additional costs and risks to taxpayers.

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<sup>1</sup> Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>2</sup> Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, *Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury*, National Consumer Law Center and Consumer Federation of America, January 31, 2002, [hereinafter "NCLC/CFA 2002 RAL Report"], available at [www.consumerlaw.org/issues/refund\\_anticipation/content/RAL\\_final.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/RAL_final.pdf).

HSBC, the RAL lender for H&R Block, has decided to stop making RALs through most independent tax preparers. HSBC will now primarily make RALs through Block and Jackson Hewitt.

New protections took effect in 2007 for military Service members. The landmark Military Lending Act protects active duty Service members from predatory lending. These protections became effective October 1, 2007, under regulations adopted by the Department of Defense. RAL lenders are prohibited from making loans to Service members that cost more than 36% APR. Because the 36% APR cap set by the Military Lending Act is all-inclusive, most RALs exceed that cap when the refund account fees and application fees are included. H&R Block is the sole exception, with a “military RAL” that is truly 36% APR.

#### A. RAL Volume Continues to Drop

RAL volume declined in 2006, as it had in 2005. The IRS data indicates there was a decrease of 6% in the number of RALs from 2005 to 2006. This was not as dramatic as the 22% decline in RALs from 2004 to 2005 but is still significant. The percentage of taxpayers who took out RALs dropped as well, from 1 in 10 taxpayers in 2004<sup>3</sup> to about 1 in 14 taxpayers in 2006.<sup>4</sup>

Based on the IRS data, we estimate there were approximately 9 million RALs made in 2006. The IRS data reports there were 10 million RAL applications in 2006.<sup>5</sup> Based upon published industry statements, we estimate about 10% of RAL applications are rejected;<sup>6</sup> however, industry representatives have informally told us that the actual rejection rate is closer to 15%. Indeed, we have been informed that the rejection rate has increased even more for 2008.

In our last two RAL reports, we estimated approximately 9.6 million RALs were taken out in 2005<sup>7</sup> and approximately 12.38 million RALs were taken out in 2004.<sup>8</sup> Part of the 2006 decline, however, is probably due to better reporting. In 2006, the IRS required tax preparers for the first time to separately report RALs versus non-loan refund

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<sup>3</sup> *Id.*

<sup>4</sup> There were 130 million returns filed in the 2006 filing season, which was for Tax Year 2005. Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>5</sup> Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>6</sup> Santa Barbara Bank & Trust, *Why You Should Choose SBBT '05*; Household International, *Exploring the Refund Anticipation Loan (RAL): Questions and Answers*, on file with the authors.

<sup>7</sup> Chi Chi Wu and Jean Ann Fox, *One Step Forward, One Step Back: Progress Seen in Efforts Against High-Priced Refund Anticipation Loans, but Even More Abusive Products Introduced*, National Consumer Law Center and Consumer Federation of America, January, 2007, at 5 [hereinafter referred to as “NCLC/CFA 2007 RAL Report.”].

<sup>8</sup> Chi Chi Wu, Jean Ann Fox, and Patrick Woodall, *Another Year of Losses: High-Priced Refund Anticipation Loans Continue To Take a Chunk Out Of Americans' Tax Refunds*, National Consumer Law Center and Consumer Federation of America, January, 2006, at 4 [hereinafter referred to as “NCLC/CFA 2006 RAL Report.”].

anticipation check (RACs) products.<sup>9</sup> Thus, prior data may have included RACs that were erroneously reported by tax preparers as RALs. RACs are further discussed in Section I.F.

Interestingly, however, the biggest drop in RALs occurred between 2004 and 2005—prior to the IRS change in reporting. RALs dropped 22% in 2005, while they dropped only 6% in 2006, the year that the IRS instituted the new RAC indicator. Thus, the reason for the steep decline in RALs in 2005 still remains unclear. It could represent an effort by commercial preparers in 2005 to ensure that tax returns associated with RACs were not marked with the RAL indicator. Alternatively, some of the decline could represent a real drop in RALs due to the cumulative effect of improved disclosures, several years of anti-RAL education efforts, and better public awareness. Other factors include the growth of nonprofit tax preparation programs for low income taxpayers and the use of software by taxpayers to prepare their own returns. In the latter two settings, RALs are either not sold or not aggressively marketed.

In 2006, for taxpayers who received refunds, the average amount was about \$2,600.<sup>10</sup> RAL loan fees for that amount were about \$100 in 2006.<sup>11</sup> Thus, taxpayers paid somewhere in the neighborhood of \$900 million in RAL fees in 2006. This compares to an estimated \$960 million in RAL fees in 2005<sup>12</sup> and \$1.24 billion in RAL loan fees in 2004<sup>13</sup> — 27% decrease since 2004.

The following chart documents the trends in RALs since the 2000 filing season:<sup>14</sup>

<b>Filing Year</b>	<b>No. of RALs</b>	<b>Increase/decrease from prior year</b>	<b>RAL loan fees</b>
2006	9 million	(-6%)	\$900 million
2005	9.6 million	(-22)%	\$960 million
2004	12.38 million	1.89%	\$1.24 billion
2003	12.15 million	(-4)%	\$1.1 billion
2002	12.7 million	5%	\$1.1 billion
2001	12.1 million	12%	\$907 million
2000	10.8 million	--	\$810 million

<sup>9</sup> IRS, Publication 1346, *Electronic Return File Specifications For Individual Income Tax Returns Tax Year 2005*, August 30, 2005, at xi.

<sup>10</sup> According to IRS data, 102 million taxpayers received refunds totaling \$264.5 billion in 2006. That averages to \$2,593 per taxpayer who received a refund. *Id.*

<sup>11</sup> NCLC/CFA 2006 RAL Report at 7.

<sup>12</sup> NCLC/CFA 2007 RAL Report at 5.

<sup>13</sup> NCLC/CFA 2006 RAL Report at 4.

<sup>14</sup> This chart is based on the data in the annual RAL reports issued by NCLC and CFA: NCLC/CFA 2007 RAL Report at 5; NCLC/CFA 2006 RAL Report at 4; NCLC/CFA 2005 RAL Report at 4; Chi Chi Wu and Jean Ann Fox, *All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low-Income Americans*, January 2004, at 4 [hereinafter referred to as “NCLC/CFA 2004 RAL Report.”]; Chi Chi Wu and Jean Ann Fox, *The High Cost of Quick Tax Money: Tax Preparation, ‘Instant Refund’ Loans, and Check Cashing Fees Target the Working Poor*, National Consumer Law Center and Consumer Federation of America, January 2003, at 1 [hereinafter referred to as “NCLC/CFA 2003 RAL Report.”]; NCLC/CFA 2002 RAL Report at 4.

The \$900 million for 2006 does not include the added fees paid for loan products that provide a RAL on the same day that the taxpayer's return is prepared. Lenders charge an additional \$25 to \$39 for same-day RALs, a fee which the consumer pays on top of regular RAL fees.<sup>15</sup> We know that H&R Block made 1.5 million "Instant Money" RALs in 2004.<sup>16</sup> Assuming a similar number in 2007, this adds at least another \$37.5 million to the RAL drain.<sup>17</sup> We do not have data on the number of same-day RALs made by the rest of the industry.

In addition to the fee charged by the RAL lender, in the past, all of the major tax preparation firms had been charging their own separate fees for RALs, sometimes called a "document processing" or "application" fee. However, H&R Block dropped this fee entirely by 2005.<sup>18</sup> Jackson Hewitt dropped this fee in its company-owned offices in 2005,<sup>19</sup> but did not drop it for all offices until 2007.<sup>20</sup> Over 5,700 of the approximately 6,500 Jackson Hewitt offices (or 87%) are franchisees,<sup>21</sup> and there are reports that some franchisees continue to impose a fee.<sup>22</sup> Liberty Tax Service agreed to drop its application fee as a result of advocacy by ACORN.<sup>23</sup>

In addition, there remains a significant sector of independent preparers that make RALs. At one point, HSBC reported partnerships with several thousand independent preparers.<sup>24</sup> Independent preparers have about 70% of the paid preparer market.<sup>25</sup> All three of the major RAL lenders made RALs through independent preparers in 2006. Santa Barbara Bank & Trust has stated that it allowed preparers to charge a document processing fee up to \$40.<sup>26</sup>

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<sup>15</sup> H&R Block, *Sample RAL and Instant RAL*, January 2008, on file with the authors; Santa Barbara Bank & Trust, *Bank Product Program 2008*, October 2007, on file with the authors.

<sup>16</sup> Peter Tufano and Daniel Schneider, *H&R Block and "Everyday Financial Services,"* Harvard Business School, October 2004, at 7.

<sup>17</sup> Note that Block customers pay an additional \$25 for an Instant RAL. H&R Block, *Sample RAL and Instant RAL*, January 2008, on file with the authors. This is significantly less than the same-day RAL surcharge for other tax preparers; thus, the drain created by these products may even be greater if we had data on industry-wide sale.

<sup>18</sup> ACORN and H&R Block Press Release, *H&R Block and ACORN Partner To Help Working Families Claim And Keep More Of What They've Earned This Tax Season*, January 14, 2005.

<sup>19</sup> Testimony of Gary P. Weinstein, Vice President, Legal and Government Affairs, Jackson Hewitt Tax Service, Before the Permanent Subcommittee on Investigations, April 15, 2005.

<sup>20</sup> ACORN Financial Justice Center, *Missing Millions: Expanding Access to the Earned Income Tax Credit While Reducing Reliance on Refund Anticipation Loans*, ACORN, January 2007, at 9.

<sup>21</sup> Jackson Hewitt Tax Service Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 28 [hereinafter "Jackson Hewitt 2007 Form 10-K"].

<sup>22</sup> Nancy Crawley, *'Quickie' Tax Refunds Come at a Dear Price*, Grand Rapids Press, Feb. 11, 2007.

<sup>23</sup> ACORN Financial Justice Center, *Missing Millions: Expanding Access to the Earned Income Tax Credit While Reducing Reliance on Refund Anticipation Loans*, ACORN, January 2007, at 9.

<sup>24</sup> In 2003, Household Finance (which was bought by HSBC) reported that H&R Block offices made up only 9,200 of the 17,300 (or 53%) outlets with which HSBC does RAL business. Household International, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 7.

<sup>25</sup> NCLC/CFA 2005 RAL Report at 15; Jackson Hewitt Tax Service, *Investor Presentation – December 2006 Update*, November 22, 2006, at 8.

<sup>26</sup> Plaintiff's Local Rule 56(a)(1) Separate Statement of Undisputed Facts at ¶8, n. 1, *Pacific Capital Bank, N.A. v. Conn.*, No. 3:06-CV-28 (D. Conn. Aug. 10, 2006).

In addition to the document processing fee, we have seen other RAL-associated fees from independent preparers. These include “e-filing”, “service bureau” and “transmission/software” fees. These fees can be very high, as much as \$185 in one case.<sup>27</sup>

Given that Jackson Hewitt did not drop the fee for all of its offices until 2007, we will assume some portion of Hewitt offices continued to charge the application fee in 2006.<sup>28</sup> We assume that the Jackson Hewitt franchisees and independent preparers who did not drop the document processing fee comprised only 25% of the market charged the fee, which would equate to 2.25 million consumers.<sup>29</sup> Using SBBT’s figure of \$40, these additional fees added about \$90 million to the amount paid for RALs in 2006. That is on top of the \$900 million in estimated RAL loan fees. Thus, taxpayers lost somewhere in the neighborhood of \$990 million collectively to get loans a mere one to two weeks sooner than they could have gotten their refunds from the IRS.

#### B. Lower Prices, More Competition

H&R Block has dropped the price of all of its RALs to 1.07% of the loan amount, plus \$29.95 for the “Refund Account Fee.”<sup>30</sup> This is the fee supposedly for the “dummy” bank account used to receive the consumer’s tax refund from IRS to repay the RAL. Block charges an additional \$20 if the consumer receives a paper check. If the customer chooses to receive the RAL by direct deposit or loaded onto Block’s Emerald Card, there is no additional fee. The Emerald Card is an electronic bank account based on a prepaid debit card platform.

Block asserts that its RALs now carry an APR of only 36%, which is a traditional maximum small loan rate cap for state usury laws. However, Block’s calculation of this APR does not include the \$29.95 charged for the Refund Account. Most tax preparers and RAL lenders do not include this fee in the APR, claiming that it is comparable to the charge for the non-loan RAC. We have challenged this unbundling in the past, for reasons explained in past RAL reports.<sup>31</sup>

If the dummy account fee is included, the APRs for Block RALs are much higher, quite dramatically for the loans in the lowest tier (\$300 to less than \$1,000), and can still be in the triple digits. Nonetheless, Block’s prices are significantly lower, especially for RALs in the range of \$1000 to \$4000 – the range in which most EITC refunds fall.

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<sup>27</sup> Loan documents on file with authors.

<sup>28</sup> Testing by advocates in Philadelphia confirmed that some Jackson Hewitt offices did charge the document processing fee in 2006. Letter to Jackson Hewitt Chairman Michael Lister from Community Legal Services, April 4, 2006, at 2.

<sup>29</sup> In 2006, Block had 4 million RALs (see Section II.A below) or about a 44% share of the market. We conservatively assume that less than half of the remaining market is charged a document processing fee.

<sup>30</sup> H&R Block, *Sample RAL and Instant RAL*, January 2008, on file with the authors.

<sup>31</sup> See NCLC/CFA 2004 RAL Report at 5.

### H&R Block 2008 Sample RAL fees<sup>32</sup>

Amount of Loan	Loan Fee
\$300	\$33.17
\$500	\$35.31
\$750	\$37.99
\$1,000	\$40.68
\$1,500	\$46.04
\$2,000	\$51.41
\$3,000	\$62.14
\$4,000	\$72.87
\$5,000	\$83.60
\$9,999	\$137.23

In addition, H&R Block has purchased a company that provides software and transmission services to independent preparers, called TaxWorks, and made this same lower pricing structure available through that channel.<sup>33</sup> Block's new offering provides a means for independent preparers to offer the same lower pricing as Block. However, as discussed in Section II.G, some of these independent preparers are fringe operators, such as payday lenders, that cause concern because they are engaged in tax preparation, hold taxpayers' sensitive financial documents, and promote other high priced products.

The other industry player to significantly reduce prices is JPMorgan Chase. Chase also charges a fee of about 1% of the loan amount plus \$32 for its version of the dummy bank account.<sup>34</sup> However, for 2008, Chase charges an additional \$10 "technology access fee," which we are informed will be dropped in 2009. Chase's loan fees are as follows.<sup>35</sup>

### JPMorgan Chase 2008 RAL Fee Schedule

Amount of Loan	Loan Fee
\$300-\$1,000	\$35
\$1,500	\$47
\$2,000	\$52
\$3,000	\$62
\$4,000	\$72
\$5,000	\$82
\$9,999	\$131

While we are heartened by Block's & Chase's decrease in RAL prices, we note that RAL prices are not the lowest they have ever been. In 1994, the price of a RAL was a flat fee of \$29 or \$35. That year, the IRS terminated the debt indicator due to RAL

<sup>32</sup> H&R Block, *Sample RAL and Instant RAL*, January 2008, on file with the authors.

<sup>33</sup> Antoinette Alexander, *The Check Is In ... The Bank*, Accounting Technology, Nov. 1, 2007.

<sup>34</sup> JPMorgan Chase, *Chase Tax Related Products – 2008 Program Highlights*, on file with authors.

<sup>35</sup> *Id.*

fraud, and the price of RALs rose significantly, to tiered prices of up to \$89.<sup>36</sup> The IRS reinstated the debt indicator in 1999 partly to lower RAL prices. RAL prices dipped for a year in 2000, but went back up in 2001.<sup>37</sup> To compare, if RAL prices had remained a flat fee comparable to \$29 or \$35, a RAL would only cost \$41.30 or \$49.85 in 2008 (the equivalent of \$29 or \$35 in 1994 adjusted for inflation).<sup>38</sup>

While Block and Chase have at least lowered their prices, their competitors continue to make hefty profits off of RALs. Jackson Hewitt uses three RAL lenders: SBBT, HSBC and Republic Bank & Trust, and its RAL pricing apparently varies by office and lender. With respect to SBBT, its prices are higher than Block or Chase, but appear to have declined a bit. SBBT now charges a fee of 1.07% of the loan amount for RALs of \$300 to \$1,000 and 2.5% of the loan amount from \$1000 to \$3800, plus a dummy account fee of \$30.95.<sup>39</sup> For loans over \$3,800, SBBT charges \$95 plus the \$30.95 dummy account fee.

**SBBT 2008 RAL Fee Schedule<sup>40</sup>**

<b>Amount of Loan</b>	<b>Loan Fee</b>
\$300	\$34.16
\$500	\$36.30
\$1,000	\$41.65
\$1,500	\$68.45
\$2,000	\$80.95
\$2,500	\$93.45
\$3,000	\$105.95
\$3,500	\$118.45
\$3,800-\$7,500	\$125.95

HSBC is the lender for RALs facilitated by H&R Block. In addition, HSBC makes loans for some Jackson Hewitt offices. Previously, HSBC had made RALs through independent preparers, but has ceased doing so except through one channel. For non-Block RALs, HSBC charges \$29.95 (for its dummy account fee) and 2.75% of the loan amount.<sup>41</sup> Thus, some sample HSBC RAL fees would be:

<sup>36</sup> A history of the debt indicator, its termination and subsequent reinstatement, and its impact on the RAL industry is set forth in Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*, National Consumer Law Center (July 2005), available at [www.consumerlaw.org/issues/refund\\_anticipation/content/Debt\\_Indicator\\_White\\_Paper.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/Debt_Indicator_White_Paper.pdf).

<sup>37</sup> *Id.* at 6-7.

<sup>38</sup> According to the Department of Labor's cost of living calculator at <http://data.bls.gov/cgi-bin/cpicalc.pl>.

<sup>39</sup> Santa Barbara Bank & Trust, *Program Newsletter 2008*, October 2007, on file with the authors.

<sup>40</sup> *Id.*

<sup>41</sup> Based on 2007 pricing, which we were informed was unchanged. See NCLC/CFA 2007 RAL Report at 13.

### HBSC Sample RAL Fees - non-Block RALs<sup>42</sup>

Amount of Loan	Loan Fee
\$300	\$38.20
\$500	\$43.70
\$1,000	\$57.45
\$1,500	\$71.20
\$2,000	\$84.95
\$3,000	\$112.45
\$4,000 and above	\$126.95

Republic Bank & Trust is a state-chartered bank based in Louisville, Kentucky that makes RALs through independent preparers. Republic's prices have remained high, as follows:

#### Republic 2008 RAL Fee Schedule

Amount of Loan	Loan Fee
\$500 or less	\$34
\$500-1,000	\$44
\$1,001-\$2,000	\$80
\$2,001-\$3,500	\$110
\$3,501-\$8,000	\$125

Thus, for RALs in 2008, a consumer can expect to pay from \$57.85 (Block) to \$110 (Republic Bank) in order to get a RAL for a typical refund of about \$2,600. The effective APR for this RAL would be 83% (Block) to 140% (SBBT) to 161% (Republic Bank).

Preparer/Bank	RAL fee (including Refund Account Fee)	APR (including Refund Account Fee)	Application/ Processing Fee	Total Fee	APR with Application Fee
H&R Block/HSBC	\$57.85	83%	none (but add \$20 if a paper check is issued for the RAL)	\$57.85	83%
Jackson Hewitt/HSBC	\$101.45	148%	may vary	---	at least 148%
Independent Preparer /Santa Barbara Bank	\$96	140%	up to \$40	up to \$136	up to 194%
Independent Preparer/JPMorgan Chase	\$58	83%	\$10 "technology fee" charged in 2008	\$68	98%
Independent Preparer /Republic Bank & Trust	\$110	161%	Unknown	---	at least 161%

<sup>42</sup> *Id.*

The good news is that the price of RALs has declined significantly for some of the biggest players in the industry, introducing real price competition. Thus, while we advise taxpayers to avoid RALs in the first place, they should shop around if they insist on getting one.

Even with price cuts, RALs continue to represent a huge drain on the tax refunds of 9 million consumers. Moreover, the fee for the RAL comes on top of the fee for tax preparation, which averages \$163 for Block<sup>43</sup> and can be higher for other preparers.<sup>44</sup> Altogether, the consumer might pay about \$221 to \$273. If the consumer chooses a tax preparer that charges a “document processing” or “application” fee of \$40 per loan, the total would rise to as much as \$261 to \$313. A low-income taxpayer could save this entire amount and still receive a quick refund using direct deposit by choosing a free tax preparation program that offers e-filing.

For the 2008 filing season, the APRs on RALs vary widely given the divergence in pricing between the industry players. They can be anywhere from about 50% (for a loan of \$10,000) to almost 500% (for a loan of \$300).<sup>45</sup> We also continue to report a version of the APR that includes application or document processing fees, if they are charged, because those fees when charged also represent a cost of the credit for a RAL. For loans with document processing or application fees, the fees can translate into APRs of about 80% (\$10,000 loan) to nearly 1,200% (\$300 loan).

Tax preparers and their bank partners also offer an “instant” same day RAL for an additional fee, from \$25 to \$39. The APRs for an instant RAL of about \$1,500 can range from 168% (Block) to 188% (Republic) to 192% (Chase). Santa Barbara Bank & Trust offers an instant RAL of \$1,000, which if the taxpayer applies for a “traditional” RAL, may be repaid from the proceeds of the second loan. In that case, the instant RAL could be a one day loan that carries an APR of over 1400%.

### C. Impact on Low-Income Taxpayers and EITC recipients

RALs are mostly marketed to low-income taxpayers. According to IRS data, 85% of taxpayers who applied for a RAL in 2006 had adjusted gross incomes of \$37,300 or less.<sup>46</sup> Industry data similarly shows that most RAL borrowers are low to moderate

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<sup>43</sup> According to industry leader H &R Block, its average tax preparation fee was about \$163 in 2006. H&R Block Inc., *2006 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 25. [Hereinafter “H&R Block 2006 Form 10-K”].

<sup>44</sup> Jackson Hewitt’s average fee is \$178. Gene Meyer, *When It’s 1040 Time, Is a Pro Worth the Price?* Kansas City Star, February 4, 2007. We have seen tax preparation fees as high as \$355. Documents on file with authors.

<sup>45</sup> These APRs are based upon a 10 day loan period. The estimated time provided by the federal government to receive a refund with e-filing and direct deposit is 8 to 15 days. IRS, *2008 IRS e-file Refund Cycle Chart*, Publication 2043, October 2007. The median time would be 11.5 days, and the loan itself takes one or two days to process.

<sup>46</sup> Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

income taxpayers.<sup>47</sup> A 2005 survey by CFA found that the majority of RAL borrowers (58.7%) earned below \$40,000.<sup>48</sup>

Despite the decline in volume, RALs continue to drain hundreds of millions of dollars from the Earned Income Tax Credit. IRS data shows that in 2006 nearly two-thirds (63%) of RAL consumers were EITC recipients, or 5.7 million families.<sup>49</sup> Yet EITC recipients made up only 17% of individual taxpayers in 2006.<sup>50</sup> Thus, EITC recipients are vastly overrepresented among the ranks of RAL consumers. In addition, IRS data shows that 28.5% of EITC recipients applied for a RAL in 2006.<sup>51</sup>

Based on this IRS data, we estimate that about \$570 million was drained out of the EITC program in 2006 by RAL loan fees.<sup>52</sup> Administrative/application fees added another \$57 million to the drain.<sup>53</sup>

Non-loan fees also drain significantly from EITC benefits. The EITC is the nation's largest anti-poverty program. One criticism has been that no other anti-poverty program requires its beneficiaries to pay for the cost of accessing the benefit, which includes both the drain created by RALs as well as tax preparation fees. Including tax preparation provides a fuller picture of how EITC benefits are chipped away. EITC recipients who got RALs paid an additional \$929 million in tax preparation fees. In addition, some percentage of these recipients paid check cashing fees.

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee (inc. dummy account fee)	\$100	\$570 million
Application/Admin. Fee (for 25%)	\$40	\$57 million
<b>Total</b>	<b>\$140</b>	<b>\$627 million</b>
Tax preparation fee	\$163	\$929million
<b>Total with tax preparation</b>	<b>\$303</b>	<b>\$1.6 billion</b>

In addition to low-income taxpayers, RALs appear to target other populations. African American and Latino taxpayers disproportionately receive RALs. Using mapping of RALs by zip code, the Neighborhood Economic Development Advocacy Project (NEDAP) found that RALs were overwhelmingly concentrated in New York

<sup>47</sup> See NCLC/CFA 2007 RAL Report at 11.

<sup>48</sup> NCLC/CFA 2006 RAL Report at 12.

<sup>49</sup> IRS data reports that 6.3 million EITC returns were associated with a RAL in 2005. Data from IRS SPEC, Tax Year 2005 Return Information (Returns Filed in 2006), May 2007. Using the 90% approval rate, see Section I.A *supra*, the number of approved RALs is 5.7 million.

<sup>50</sup> There were 22 million EITC returns in 2006 and 130 million individual tax returns in 2006. Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>51</sup> Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>52</sup> At a fee of \$100 for a RAL for the average refund times 5.7 million.

<sup>53</sup> Weighted to 25%, see Section I.A, *supra*.

City's lowest income neighborhoods of color.<sup>54</sup> The New York State Division of Human Rights sued both Jackson Hewitt and Liberty Tax Service for discriminatory targeting of minorities for RALs, in violation of that state's Human Rights Law.<sup>55</sup> Prior analysis by NCLC and the Brookings Institution also found racial disparities in RAL lending.<sup>56</sup>

RALs are also heavily concentrated in Native American reservations.<sup>57</sup> A survey on predatory lending administered to the attendees at the National American Indian Housing Council meeting in May 2007 found more respondents identified RALs as a "big problem" than any other high-cost lending product.<sup>58</sup>

#### D. Risks of RALs

In addition to their costs, RALs present significant risks to their borrowers. A RAL must be repaid even if the taxpayer's refund is denied, is smaller than expected, or is frozen. If the taxpayer cannot pay back the RAL, the lender may send the account to a debt collector. The unpaid RAL will also show up as a black mark on the taxpayer's credit record. Thus, even with lower costs, taxpayers are advised to avoid RALs to prevent these problems.

For example, one RAL borrower sent us this story:

I went into a local to Las Vegas NV HR Block to file my tax return. Everything went through just fine and I went ahead and filed for a rapid refund. I received [sic] my rapid refund as expected but that was the end of the smooth ride with HR Block and HSBC.

What I was told by the IRS was that HR Block transmitted an incorrect Account number for the deposit of my tax refund check so HSBC would not be getting it on time. So I called (after hunting around a while) HSBC to make them aware of the situation. At the time they were nothing but helpful. Told me when I received the check just send it there way via FedEx so I could track it, and they could deposit it.

For some reason I never did receive the check from the IRS. I called a number for times, they would remail me the check and it would never show up in my mail

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<sup>54</sup> Chris Keeley, Sarah Ludwig and Mark Winston Griffith, *Predatory Tax-Time Loans Strip \$324 Million From New York City's Poorest Communities: An Analysis of Tax Refund Anticipation Lending in NYC 2002 – 2005*, Neighborhood Economic Development Advocacy Project, January 2007, available at <http://www.nedap.org/documents/FINAL2007NEDAPRALsreport.pdf>.

<sup>55</sup> Complaint, New York State Division of Human Rights v. Jackson Hewitt, Jan 17, 2008; Complaint, New York State Division of Human Rights v. JTH Tax, Inc, Jan 17, 2008. See also Nicholas Confessore, *State Makes Bid to End Costly Tax-Refund Loans*, New York Times, January 18, 2008.

<sup>56</sup> NCLC/CFA RAL Report at 7-8.

<sup>57</sup> Brian Tumulty and Faith Bremner, *Indians Top Users of Rapid Refunds*, Sioux Falls Argus Leader, Mar. 19, 2007 (57% of taxpayers who received refunds in four Native American reservations in South Dakota used RALs.)

<sup>58</sup> Miriam Jorgenson, Sarah Dewees, and Karen Edwards, *Borrowing Trouble: Predatory Lending in Native American Communities*, First Nations Development Institute (2008).

box. To this day we still are unaware of just where that check has gone. And the IRS is trying to figure this one out on there end.

Things began to get a tad harry [sic] 3 months later. I asked if I could make payment arrangements so that I can repay what was owed to HSBC due to HR blocks error. At first HSBC was more then willing to make arrangements for me to pay them back via increments of 250 dollars a month until I was able to pay off the full amount, of something to the tune of 4500 dollars.

A month after they had agreed to the payments they defaulted on there end of the deal, started calling me daily asking where there money was, not the 250 mind you but the full amount due. I told them time and time again that I was making payments per there arrangement and that was all I could afford. Day after day, and for three months daily I would receive calls at home, work, anywhere they had my personal information. They wouldn't just call once however, they would call upwards of 5 times a day. The whole time they where calling I was continuing to pay them there 250 dollar a month payment. And I have full proof of this. I have currently as of today paid about 3000 back of the original note, and still am being harassed.

Now also as a part of a deal with an arbitrator. They where to stop placing derogatory marks on myself, and my husbands Credit because we where making payments when they where asking for them on time every month. To date they have yet to stop, yesterday they placed it on Charge Off status on my Credit even though I have made all payments that I said I would. They refuse to stop pounding my credit.

I also have been threatened with wage garnishment, and that I know is illegal. Considering they have to go through the courts before they can make such a statement over a phone line.

There is another significant risk if the IRS denies or reduces a taxpayer's refund, leaving her with unpaid RAL debt – the practice of cross-lender debt collection of prior year's unpaid RALs. If the taxpayer with unpaid RAL debt applies for a RAL or RAC from a commercial preparer in any subsequent year, she will find that her subsequent year's refund gets seized to repay the prior unpaid RAL debt. Cross-lender debt collection has been explained in detail in prior NCLC/CFA RAL Reports<sup>59</sup> and is the subject of several lawsuits, including one in which NCLC is co-counsel.<sup>60</sup>

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<sup>59</sup> NCLC/CFA 2007 RAL Report at 16-17; NCLC/CFA 2004 RAL Report at 19-20; NCLC/CFA 2002 RAL Report at 24.

<sup>60</sup> Complaint, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara March 18, 2003), available at [www.consumerlaw.org/issues/cocounseling/content/s\\_barbara\\_case.pdf](http://www.consumerlaw.org/issues/cocounseling/content/s_barbara_case.pdf).

E. IRS Concerns over Fraud and RALs

RALs are often involved in cases of tax fraud. On April 2, 2007, the U.S. Department of Justice (DOJ) sued 5 Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. DOJ alleged that the owners and managers of these franchisees “created and fostered a business environment ... in which fraudulent tax return preparation is encouraged and flourishes.” Examples of fraud alleged by DOJ include filing false returns claiming refunds based on phony W-2 forms; using fabricated businesses and business expenses on returns to claim bogus deductions; claiming fuel tax credits in absurd amounts for customers clearly not entitled to any credits; and massive fraud related to EITC claims.<sup>61</sup>

RALs were involved in the fraud committed by these Jackson Hewitt franchisees. The lawsuits against all of the franchisees alleged:

“Many of [franchisees’] stores cater to prospective customers who are not entitled to tax refunds but who seek to obtain fast money in the form of Jackson Hewitt "Holiday Express Loan Program" (HELP) loans, "Money Now" loans, or Refund Anticipation loans (RALs) secured by fabricated tax refunds fraudulently claimed on Jackson Hewitt prepared and filed tax returns.”<sup>62</sup>

In addition, one of the lawsuits alleged:

“In 2007, a Smart Tax/Jackson Hewitt return preparer offered to fraudulently manipulate a customer's 2006 return information so the customer would qualify for a RAL.”<sup>63</sup>

The role of RALs in fraud has prompted the IRS to open a rulemaking proceeding regarding potential RAL regulation. In January 2008, the IRS issued a request for comments regarding whether it should develop rules restricting the sharing of tax return information to market RALs, RACs, audit insurance and other financial products typically sold to low-income taxpayers.<sup>64</sup> The IRS specifically asked for information about whether these products provide preparers with a financial incentive to inflate refund claims inappropriately. The IRS is accepting comments on the issue until April 7, 2008.

Prior NCLC reports have discussed the role of RALs in tax fraud, especially with respect to the Debt Indicator. The IRS dropped the Debt Indicator in 1994 due to

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<sup>61</sup> Complaint, *United States v. Smart Tax of Georgia, Inc.*, 1:07CV-0747 (N.D. Ga. Apr. 2, 2007); Complaint, *United States v. Smart Tax Inc.*, 07C-1802 (N.D. Ill. Apr. 2, 2007); Complaint, *United States v. Sofar, Inc.*, Civ. No. 2:07-cv-11460 (E.D. Mich. Apr. 2, 2007); Complaint, *United States v. Smart Tax of North Carolina, Inc.*, Civ. No. 5:07-cv-00125-FL (E.D.N.C. Apr. 2, 2007). All of the complaints are available at <http://www.usdoj.gov/tax/txdv07215.htm>.

<sup>62</sup> *Id.*

<sup>63</sup> Complaint, *United States v. Smart Tax Inc.*, 07C-1802 (N.D. Ill. Apr. 2, 2007).

<sup>64</sup> 73 Fed. Reg. 1131 (Jan. 7, 2008).

concerns over mounting fraud in refund claims.<sup>65</sup> IRS data had indicated that 92% of fraudulent returns filed electronically involved RALs.<sup>66</sup> After the IRS reinstated the Debt Indicator, fraud appears to have increased. The then-Director of the IRS Criminal Investigation Division's Refund Crimes Unit noted that e-file fraud had increased by more than 1,400 percent since 1999, when the Debt Indicator was reinstated.<sup>67</sup>

NCLC and CFA will be filing comments in response to the IRS request for comments that further discuss the role of RALs in fraud.

#### F. RACs and Bank Accounts

Refund anticipation checks (RACs) are a non-loan payment device offered by RAL banks. With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund check. After the refund is deposited, the bank issues the consumer a paper check or prepaid debit card with the RAC proceeds and closes the temporary account.

RACs generally cost around \$30. In 2006, the IRS data for the first time required tax preparers to separately report out RACs, which enables us to determine the amount taxpayers paid for RACs. In 2006, nearly 10.8 million taxpayers received a RAC,<sup>68</sup> at a cost of about \$324 million.

Interestingly, the number of RACs sold to consumers actually exceeds the number of RALs. RACs present different issues than a RAL. They are less expensive than a RAL, although they are still very pricey for what is essentially a one-time use bank account. Instead of a RAC, taxpayers should be encouraged to open real bank accounts. They can receive refunds in the same time frame as a RAC by having their refunds direct deposited into their account, and can avoid paying check cashing fees to access funds from a RAC. Greater bank account usage may also help reduce the number of RALs. A study of low and moderate income residents found that taxpayers without bank accounts were twice as likely to take out RALs as taxpayers who had bank accounts.<sup>69</sup>

For taxpayers without bank accounts, there are other options for receiving fast refunds. H&R Block customers who received the Emerald Card last year could have this year's refunds direct deposited onto those cards, and avoid the fee for a RAC altogether.

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<sup>65</sup> This history is summarized in Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*, National Consumer Law Center, July 2005, available at [http://www.consumerlaw.org/issues/refund\\_anticipation/content/Debt\\_Indicator\\_White\\_Paper.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/Debt_Indicator_White_Paper.pdf).

<sup>66</sup> *Id.* at 10.

<sup>67</sup> Allen Kenney, *IRS Official Shines Spotlight on E-Filing Fraud*, 2004 Tax Notes Today 130-4, July 6, 2004.

<sup>68</sup> Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>69</sup> Michael S. Barr and Jane K. Dokko, *Tax Filing Experiences and Withholding Preferences of Low- and Moderate-Income Households: Preliminary Evidence from a New Survey*, in Proceedings of the IRS Annual Research Conference. Washington, DC: IRS, 2006, at 200, available at <http://www.irs.gov/pub/irs-soi/06barr.pdf>.

Western Union also partnered with free tax preparation sites to offer a service that allowed taxpayers to receive their refund in cash for a \$10 fee.<sup>70</sup>

However, none of the above alternatives achieves another purpose of RACs – the ability to avoid paying tax preparation fees up front. If the consumer simply has her refund direct deposited into her own bank account, the consumer must pay preparation fees out-of-pocket. Thus, RACs may in some cases be disguised loans to pay preparation fees. If the RAC fee were to be treated as a finance charge for the loan of a tax preparation fee, based on a typical fee of \$165, the APR for this loan would be 633%.

There may be alternatives for payment of preparation fees that are less expensive than a RAC. Santa Barbara Bank & Trust offers a “Fee Collect” product for \$15 per return.

There have been a few cases of consumer problems with RACs. Intuit and SBBT offered a RAC on Turbo Tax preparation software that was marketed as a way to avoid using a credit card to pay for a \$16.95 e-file fee. Unfortunately, the RAC cost \$29.95, and consumers complained that the fee was not made clear to them when they used the product.<sup>71</sup>

In addition to the RAC fee itself, many tax preparers who charge fees for “document processing” or e-filing will charge these fees for RACs as well. This can significantly add to the expense of a RAC, from \$10 to as much as \$185.

Finally, note that RACs do involve a bank account, and as such may be required to comply with the Truth in Savings Act (TISA) and the Electronic Funds Transfer Act (EFTA). HSBC states in its RAC documentation that it does not provide periodic statements for RACs, an EFTA requirement for bank accounts.<sup>72</sup>

#### G. End to Pay Stub and Holiday RALs

Another positive development this year was the near total elimination of “pay stub” and “holiday” RALs. These were RALs made prior to the tax filing season, before taxpayers received their IRS Form W-2s and could file their returns. These RALs presented additional costs and risks to taxpayers. NCLC and CFA had issued a report on pay stub RALs<sup>73</sup> and were part of a coalition that called on the Comptroller of the Currency to prohibit national banks from making these loans.

During the spring of 2007, all three of the major RAL banks –HSBC, SBBT and JPMorgan Chase -- announced they would stop offering these loans. The banks did not

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<sup>70</sup> Brochure, Western Union Payment Services, undated, on file with the authors.

<sup>71</sup> Teresa Dixon Murray, *The Scuzzy Award Goes to TurboTax*, Cleveland Plain Dealer, Apr. 9, 2007.

<sup>72</sup> HSBC, *Application for a Refund Anticipation Loan and a Refund Deposit Account*, 2007, on file with the authors.

<sup>73</sup> Chi Chi Wu and Jean Ann Fox, *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom*, National Consumer Law Center and Consumer Federation of America, November 2006, available at [www.consumerlaw.org/issues/refund\\_anticipation/content/PaystubRALsReport.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/PaystubRALsReport.pdf).

state their reason for discontinuing pay stub and holiday RALs, but SBBT has admitted it suffered losses from fraud in the program.<sup>74</sup> In particular, SBBT stated that it had lost money on pay stub RALs, but that holiday RALs made a slight profit.<sup>75</sup> HSBC discontinued its program after meeting with consumer advocates and others.<sup>76</sup>

While pay stub and holiday RALs are essentially gone, H&R Block, through its own bank, is now offering a credit product to its tax clients, the Emerald Advance Line of Credit. This loan is not explicitly tied to tax preparation, although we assume many borrowers will end up using their tax refund to repay it, since the loan is due in full on February 15. The Emerald Line of Credit carries an interest rate of 36% plus an annual fee of \$30, which is much less expensive than short-term fringe lending products such as payday or auto title loans.

While all of the major RAL banks have stopped making pay stub and holiday RALs, there may be some fringe lenders that still make them, such as payday loan stores. At least one payday loan store was exploiting last year's marketing to offer "HOLIDAY LOANS For a limited time bring in your last pay stub and we will loan you up to \$1000."<sup>77</sup>

#### H. RALs to Military Service Members

Active duty Service members and their families are better protected against high cost RALs in 2008. The John Warner Defense Authorization Act of 2007<sup>78</sup>, also known as the "Military Lending Act" (MLA) caps rates for loans to the military at 36% APR including fees and insurance premiums. The Department of Defense issued regulations that define RALs as one of three loan products covered by the new federal protections.<sup>79</sup> The regulations, effective October 1, 2007, cap interest rates for loans secured by expected tax refunds at 36% annual interest, which includes all fees associated with extending credit (Military APR). Thus, the "Refund Account" fee charged by RAL lenders for the dummy account used to repay the loan must be included in the Military APR.

This tax season, H&R Block offered reduced rate RALs to Service members at 137 outlets located near major military bases. Block and its partner MetaBank offered loans that cost slightly under 36% Military APR, since MetaBank did not charge the Refund Account Fee. (At other Block outlets, RALs cost 83% APR for the average \$2,600 refund, including both RAL interest and Refund Account fees.) This is a truly 36% RAL from a commercial preparer, which shows that such a loan product is possible.

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<sup>74</sup> Carl Gutierrez, *Red Faces at Pacific Capital*, Forbes, October 31, 2007.

<sup>75</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, October 29, 2007.

<sup>76</sup> Diane Freda, *HSBC Discontinues Paystub Loans After Talks With Consumer Advocates*, BNA Banking Report, March 19, 2007.

<sup>77</sup> Advertisement from American Cash Center, on file with authors.

<sup>78</sup> John Warner National Defense Authorization Act for Fiscal Year 2007, § 670, codified at 10 U.S.C. § 987.

<sup>79</sup> 32 C.F.R. § 232.3

The loan proceeds can be delivered through direct deposit to the borrower's bank account for no additional cost, or can be loaded onto the ANEW prepaid debit card issued by Block Bank. As required by the MLA, the Block loan contract exempts military personnel from the mandatory arbitration clause that otherwise applies to RALs from MetaBank. Block's "Additional Terms" for Military RALs authorizes the tax preparer to share tax return and loan information with other banks that provide RALs.<sup>80</sup>

This year, Jackson Hewitt did not offer Service members a loan product secured by the borrower's anticipated tax refund. Instead, banners in tax preparation offices and an advertisement on Jackson Hewitt's website home page directed clients to Pioneer Military Lending to apply for an installment loan. Those installment loans are not subject to the Department of Defense regulations defining what is covered by the MLA, and thus do not need to comply with a rate cap or the MLA's other protections.<sup>81</sup>

The Jackson Hewitt/Pioneer Military Lending page offers loans of \$500 to \$10,000 which are not secured by tax refunds. The Pioneer home page includes no information about the cost or terms of loans, at least not prior to filing an application and providing extensive personal information. A Jackson Hewitt manager told a Texas reporter that the Pioneer interest rate was about 23 % and that customers may use their tax refunds to pay off the loans. It is not clear that this quote included loan application fees, insurance premiums or other costs for installment loans from Pioneer.<sup>82</sup>

In one example provided to CFA and NCLC, Pioneer Loan offered a loan of \$1,050 to a Service member, repayable in 13 monthly installments. The Truth in Lending disclosure listed \$203.10 in finance charges plus \$33.38 in "voluntary" credit insurance premiums for a total repayment of \$1,286.48. While the disclosed APR was 27.34%, this APR did not include the insurance premiums, which would have been required to be included in calculating the Military APR. If the Pioneer loan was subject to the MLA rules, the Military APR of 36.44% would exceed the rate cap set by Congress.

For NCLC/CFA's RAL report last year, Dr. Steven Graves of California State University at Northridge mapped the location of RAL facilitators in Washington State and North Carolina, two states that require these entities to register and that have large military installations within their borders. The 2007 maps illustrated a higher incidence of RAL facilitators than the population alone would justify. Dr. Graves updated the maps for Washington State and North Carolina, using the state RAL facilitator lists posted February 27, 2008, and found little change from the prior year. This is not surprising, since tax preparation is the main line of business for these facilitators.

Service members fit the description of taxpayers who are likely to take out RALs. IRS data shows that 323,142 Service members used a military VITA site in 2006 to prepare their tax returns for tax year 2005. Over 90 percent of these military VITA site

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<sup>80</sup> H&R Block Military RAL contract, January 18, 2008, on file with authors.

<sup>81</sup> [www.jacksonhewitt.com](http://www.jacksonhewitt.com), visited January 18, 2008, linked to <http://landing.pioneermilitaryloans.com/affiliateLanding...>

<sup>82</sup> Don Bolding, *Tax Firm Develops 'Military RAL,'* Killeen Daily Herald, Feb. 4, 2008.

filers received a refund. Almost twelve percent of Service members at military VITA sites filed returns in 2006 with EITC claims worth \$61,517,354. Over 24% of them claimed the child tax credit worth \$99,545,643, plus additional child tax credits worth another \$65,435,476. Almost five percent of military families using military VITA sites filed returns with both a child tax credit and EITC, same as the prior year.<sup>83</sup>

This data indicates that a sizeable portion of military taxpayers receive tax credits. Prior to October 2007, those Service members who received the EITC and/or child tax credits and who used paid preparers probably had been losing a portion of their credits to RALs and other fees.

## I. Other Developments

### *Tax Season Delay*

Because Congress was late in enacting its annual “fix” for the Alternative Minimum Tax, taxpayers had been facing the possibility of a delay in tax season to early February. Fortunately, the IRS announced in late December that tax season would start on time for everyone, except about 13.5 million taxpayers (only 3 to 4 million of whom are early-season filers who might be affected by a delay). The IRS began accepting those returns on Feb. 11, 2008.

### *Free File*

The Free File Alliance is a consortium of commercial preparation websites that offer free services to income eligible taxpayers when they access a link through [www.irs.gov](http://www.irs.gov). Over the past few years, the number of returns filed through the Free File program decreased from 5 million to 3.7 million. While part of the reason may be due to the income limits of the program, another reason may be deceptive advertising by “competing” on-line tax preparation websites that misdirect taxpayers when the taxpayers conduct a Google search for ‘Free File’.<sup>84</sup>

A class action lawsuit was filed against Free File Alliance members on behalf of taxpayers who paid e-filing fees, alleging that such fees were excessive.<sup>85</sup> The Free File Alliance had excluded an on-line filing program offered by the Legal Aid Society of Orange County from the IRS website, until the National Taxpayer Advocate raised the issue.

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<sup>83</sup> Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>84</sup> Teresa Dixon Murray, *The Trouble with E-File*, Cleveland Plain Dealer, Apr. 16, 2007.

<sup>85</sup> Complaint, *Byers v. Intuit, Inc.*, Case No. 2:07-cv-04753 (E.D. Pa. Nov. 13, 2007).

## PART II. INDUSTRY PLAYERS

This section provides basic information on the RAL activity of key industry players, an overview that we provide annually in our RAL reports. We discuss certain other topics affecting these players, such as law enforcement actions, reform measures by certain companies, and other events, in other parts of this report.

The RAL industry is made up of three commercial preparation chains and thousands of independent preparers that offer and arrange for RALs. The loans are made by banks because of the banks' ability to avoid state interest rate caps and because IRS rules prohibit the tax preparer from being the RAL lender.<sup>86</sup>

### A. H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 15.7% of all individual tax returns in 2006.<sup>87</sup> In 2006, Block's RAL business declined somewhat. Block made 4 million RALs,<sup>88</sup> compared to 4.2 million in 2005.<sup>89</sup> Block processed 15.7 million tax returns (excluding software/online processed returns) in 2006;<sup>90</sup> thus, about 25% of customers who went to a Block office received RALs that year. Block's RAL business again declined slightly in 2007, to 3.85 million<sup>91</sup>

Block earns fees from RALs through its arrangement to have Block Financial Corporation buy a 49.9% interest in RALs arranged by its tax preparation offices. In 2006, Block earned \$178 million in revenues from RALs, representing about 7.3% of the company's revenues from tax services.<sup>92</sup> In 2007, Block's RAL profits rose to \$192.4 million plus \$17.6 million from its participation share in pay stub RALs.<sup>93</sup> This constituted 7.8% of tax services revenue.<sup>94</sup>

Over the years, Block has instituted a number of reforms in its RAL and financial product offerings. In 2007, it introduced the Emerald Card, a low cost bank account based on a prepaid debit card platform. The Emerald Card has the distinction of being one of the few bank accounts that does not permit consumers to overdraw their accounts using a debit card – a practice NCLC, CFA, and other consumer groups have heavily criticized. Block sold 2 million Emerald Cards in 2007.<sup>95</sup>

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<sup>86</sup> See NCLC/CFA 2002 RAL Report at 18-19.

<sup>87</sup> H&R Block 2006 Form 10-K at 4.

<sup>88</sup> *Id.* at 25.

<sup>89</sup> H&R Block Inc., *2005 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 22. [hereinafter "H&R Block 2005 Form 10-K"].

<sup>90</sup> H&R Block 2006 Form 10-K at 25.

<sup>91</sup> H&R Block Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 26. [hereinafter "H&R Block 2007 Form 10-K"].

<sup>92</sup> H&R Block 2006 Form 10-K at 5, 25.

<sup>93</sup> H&R Block 2007 Form 10-K at 6.

<sup>94</sup> *Id.* at 26.

<sup>95</sup> William Launder, *At Crossroads, Block Ups Bet on Underbanked*, *American Banker*, June 26, 2007.

In addition, Block took the lead in lowering RAL prices. Its Emerald Card Line of Credit is far less costly than credit sources such as payday loans. The company appears to have been going in the right direction with respect to its tax-related financial services products.

Of concern to us is the recent change in Block's leadership, with hedge fund manager Richard Breeden replacing CEO Mark Ernst. Breeden has publicly stated he is considering getting rid of Block Bank, which is the entity that enables the Emerald Card and other elements of Block's reform.<sup>96</sup> In addition, certain Block officials who had been responsible for positive changes are no longer with the company.

Thus, we are concerned that Block may halt or even reverse its course of reform under the leadership of Breeden or his appointees. Such a reversal would be most unfortunate, because we believe that Block's reform measures have not only benefited consumers, but have enabled the company to be in the best position among its competitors should RALs be eliminated. The Emerald Card provides a mechanism for Block to deliver speedy refunds to consumers without traditional bank accounts, should RALs be eliminated or the IRS finally achieve its goal of delivering e-filed direct deposit refunds in a few days.

#### B. HSBC

HSBC is the RAL lender for H&R Block. In addition, HSBC previously had made RALs through independent preparers. HSBC has decided to stop making RALs through independent tax preparers, and only work with Block, Jackson Hewitt and one other channel.<sup>97</sup>

HSBC reported that in 2006, it had over 10.6 million refund product customers.<sup>98</sup> It is unclear whether these accounts were all RALs, or whether some RACs were included in the mix. HSBC's RAL/RAC income was \$257 million in 2006, representing an 8% decrease from its income of \$277 million in 2005.<sup>99</sup> HSBC originated \$16.1 billion in RAL volume in 2006.<sup>100</sup>

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<sup>96</sup> *H & R Block Boss Resigns As Chairman, CEO*, Associated Press, Nov. 20, 2007.

<sup>97</sup> Antoinette Alexander, *The Check Is In ... The Bank*, Accounting Technology, Nov. 1, 2007.

<sup>98</sup> HSBC Finance Corp., *2006 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 11 [hereinafter "HSBC 2006 Form 10-K"].

<sup>99</sup> *Id.* at 51.

<sup>100</sup> *Id.* at 11.

### C. Jackson Hewitt

Jackson Hewitt is the second largest tax preparation chain in the country, preparing 3.7 million returns in 2006, or about 2.8% of all individual tax returns.<sup>101</sup> Its main bank partner for RALs and other tax financial products is Santa Barbara Bank and Trust (SBBT), which provides 65% of Hewitt's RALs.<sup>102</sup> Jackson Hewitt also has a partnership with HSBC, and Republic Bank & Trust of Kentucky.<sup>103</sup>

In 2006, Jackson Hewitt sold tax financial products to about 3.4 million (or 92%) of its customers.<sup>104</sup> Given that it made 1.2 million RALs in 2005,<sup>105</sup> and its 10% growth in financial products from 2005 to 2006,<sup>106</sup> we assume Jackson Hewitt brokered about 1.3 to 1.4 million RALs in 2006.

In 2007, Jackson Hewitt's numbers appear to be similar to 2006. The company processed 3.65 million tax returns<sup>107</sup> and about 3.4 million (or 93%) of these taxpayers were sold a financial product.<sup>108</sup> We assume that the number of RALs remained flat as well.

Jackson Hewitt continues to derive a startling percentage of its profits from financial products. It earned \$80 million in financial product fees in 2006, about 29% of its total revenues.<sup>109</sup> It earned a similar amount in 2007.<sup>110</sup> Jackson Hewitt receives payments from SBBT and HSBC "for providing access to Jackson Hewitt offices and supporting the technology needs of the program, as well as a variable payment upon the attainment of certain contractual growth thresholds."<sup>111</sup>

Jackson Hewitt is much more dependent than Block on RALs and other tax financial products. The company has admitted that "Our tax return preparation business is, to some extent, dependent on our customers' ability to obtain financial products through our tax return preparation offices."<sup>112</sup> It has also admitted that it could suffer a loss of customers due to the demise of pay stub RALs.<sup>113</sup>

Jackson Hewitt and its franchisees have been the subject of a number of government enforcement actions. In January 2007, the company settled a lawsuit with

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<sup>101</sup> Jackson Hewitt Tax Service Inc., *2006 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 2 [hereinafter "Jackson Hewitt 2006 Form 10-K"].

<sup>102</sup> *Pacific Capital Bancorp Conference Call*, Financial Disclosure Wire, Nov. 1, 2007.

<sup>103</sup> See <http://www.jacksonhewitt.com/?ProductsRefund>, visited March 25, 2008.

<sup>104</sup> Jackson Hewitt 2006 Form 10-K at 25. This includes RALs, RACs and Hewitt's "Gold Guarantee."

<sup>105</sup> Jackson Hewitt 2005 Form 10-K at 24.

<sup>106</sup> Jackson Hewitt 2006 Form 10-K at 30.

<sup>107</sup> Jackson Hewitt Tax Service Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 3 [hereinafter "Jackson Hewitt 2007 Form 10-K"].

<sup>108</sup> *Id.* at 28.

<sup>109</sup> Jackson Hewitt 2006 Form 10-K at 29.

<sup>110</sup> Jackson Hewitt 2007 Form 10-K at 27.

<sup>111</sup> *Id.* at 22.

<sup>112</sup> *Id.* at 14.

<sup>113</sup> *Id.* at 15.

the California Attorney General over its promotion of RALs and RACs, its cross-lender debt collection practices, and alleged violation of IRS privacy rules. Jackson Hewitt agreed to reform its practices and pay \$4 million in consumer refunds plus \$1 million in penalties and costs.<sup>114</sup>

In April 2007, the U.S. Department of Justice sued 5 Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. These lawsuits are discussed in more detail in Section I.E. As a result of these lawsuits, Hewitt was required to charge off \$8.3 million in losses, and paid a \$1.5 million fine to the IRS.<sup>115</sup> Jackson Hewitt bought back the franchises that were sued, paying their owners \$19 million.<sup>116</sup>

#### D. Santa Barbara Bank & Trust/Pacific Capital Bancorp

Jackson Hewitt's main RAL partner, Santa Barbara Bank & Trust (SBBT), a subsidiary of Pacific Capital Bancorp, originated 6.7 million RALs and refund anticipation checks in 2006.<sup>117</sup> The product mix for that year was 70% refund anticipation checks and 30% RALs.<sup>118</sup> This means SBBT made about 2 million RALs in 2006.

SBBT earned \$110 million in RAL fees in 2006 and \$44.9 million in refund anticipation check fees.<sup>119</sup> There was a significant increase in RAL income due to a new financial arrangement with Jackson Hewitt.<sup>120</sup> SBBT relies heavily on its RAL and RAC income, which constitute 56% of the bank's after-tax income.<sup>121</sup>

In 2007, SBBT made 1.83 million RALs.<sup>122</sup> That year, SBBT suffered large loan losses due to fraud by tax preparers and clients, including fraud that was the subject of the U.S. Department of Justice action described in Section I.E. The bank was required to charge-off \$62.7 million in RAL losses in the first quarter of 2007, an increase of 53.6% from 2006.<sup>123</sup> The bank's loan loss rate on RALs increased from 1.25% to 2% in 2007. The bank was forced to set aside \$6 million because of the DOJ lawsuit and eventually

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<sup>114</sup> Judgment, *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Sup. Ct. Alameda Cty Jan. 3, 2007), available at [http://ag.ca.gov/cms\\_pdfs/press/2007-01-03\\_Jackson\\_Hewitt\\_Settlement\\_Judgment.pdf](http://ag.ca.gov/cms_pdfs/press/2007-01-03_Jackson_Hewitt_Settlement_Judgment.pdf).

<sup>115</sup> *Jackson Hewitt Quarterly Loss Widens*, Reuters, Nov. 27, 2007.

<sup>116</sup> Lynnley Browning, *Jackson Hewitt to Cut Ties with Franchiser*, New York Times, Sept 29, 2007, C1.

<sup>117</sup> Pacific Capital Bancorp, *Form 10-Q: Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended June 30, 2006*, at 50.

<sup>118</sup> *Id.*

<sup>119</sup> Pacific Capital Bancorp, *2006 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 23, 35. [hereinafter "PCB 2006 Form 10-K"]

<sup>120</sup> *Id.* at 23.

<sup>121</sup> Martha Sadler, *Borrowers Beware*, Santa Barbara Independent, Oct. 25, 2007.

<sup>122</sup> Pacific Capital Bancorp Conference Call, *Financial Disclosure Wire*, Nov. 1, 2007.

<sup>123</sup> Katie Kuehner-Hebert, *In Brief: Pacific Capital Cites Tax Loan Problems*, American Banker, Apr. 25, 2007.

took a \$22 million hit in unpaid RALs due to fraud.<sup>124</sup> Part of the increase in fraud losses was caused by pay stub and holiday RALs.<sup>125</sup>

Despite these losses, SBBT's senior management has stated the bank will stay in the RAL business.<sup>126</sup> According to analysts, SBBT's RAL business has been drag on its stock price.<sup>127</sup>

#### E. Liberty Tax Service

Liberty Tax is the third significant commercial tax preparation chain in the country, with 2,700 locations.<sup>128</sup> It estimates that it will process about 1.3 million returns in 2008, with about 20% getting a RAL – or about 260,000.<sup>129</sup> The chain is well-known for hiring people to dress up in Statue of Liberty costumes as a form of advertisement during tax season.<sup>130</sup>

#### F. Other Banks

In addition to HSBC and SBBT, there are a handful of other banks that make RALs. The largest of these banks is JPMorgan Chase, which has recently lowered its prices to a level comparable to H&R Block. However, Chase is charging an additional \$10 “technology access fee” for 2008. This fee essentially represents a payment to compensate the software providers/transmitters, because Chase has eliminated the per RAL financial incentives to transmitters and preparers. Thus, we assume transmitters were earning \$10 per return with a RAL. Chase has also stated it will cash RAL checks that it issues for free, and that Chase RAL checks can also be cashed at Wal-Mart stores.

Another RAL lender that has vigorously pursued independent preparers is Republic Bank & Trust in Louisville, Kentucky. In fact, Republic's advertising on its website promises tax preparers “Fast and Aggressive RAL Approvals.” Republic even touts that “95% of RAL applications are approved with most checks released within minutes of the IRS acknowledgement.”<sup>131</sup> Unfortunately, independent tax preparers attracted by “aggressive RAL approvals” may be the most questionable type of preparer. In February 2008, a coalition of consumer groups, including NCLC and CFA, sent a letter to FDIC Chairman Sheila Bair asking that the FDIC undertake additional examination and enforcement action over Republic's RAL program.

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<sup>124</sup> Press Release, *Pacific Capital Bancorp Provides Update on Performance of 2007 Refund Anticipation Loan and Refund Transfer Programs*, October 29, 2007.

<sup>125</sup> *Pacific Capital Bancorp Conference Call*, Financial Disclosure Wire, October 29, 2007 (stating that two-thirds of the increase in loan loss rates was due to pay stub and holiday RALs).

<sup>126</sup> *Id.*

<sup>127</sup> Alan Kline, *Despite 3Q Hit, Pacific Capital Bullish on RALs*, American Banker, Nov. 1, 2007 (quoting analyst Manuel Ramirez stating “investors have tended to vote with their feet on that [RAL business]”).

<sup>128</sup> Press Release, *Liberty Tax Service Releases Results through January 31<sup>st</sup>*, February 6, 2008.

<sup>129</sup> Michael Schwartz, *IRS Plan Irks Tax Firms*, Hampton Roads Business Journal, January 21, 2008.

<sup>130</sup> Margarita Bauza, *Costumed Wavers Put a Face on Tax Service Company*, Detroit Free Press, February 9, 2008.

<sup>131</sup> <https://www.republicrefund.com>.

Other RAL banks are River City Bank<sup>132</sup> and Fort Knox Financial Services/Ohio Valley Bank,<sup>133</sup> both located in Louisville, Kentucky. There are a handful of banks that may have small scale RAL operations.<sup>134</sup>

## G. Fringe Providers

### 1. *Check Cashers and Payday Lenders*

Tax refunds have a significant impact on high cost lenders such as payday loan outlets and pawn shops. Industry analysts note that payday loan customers use tax refunds to pay off payday loans or to pay defaulted loans. Pawn customers use tax refunds to buy merchandise at pawn shops.<sup>135</sup> Typically, loan volume trends downward early in the year as consumers with payday or pawn loans use RAL and refund proceeds to take a break from the payday loan debt treadmill.

Fringe financial providers also offer tax preparation and RAL services to their customers, using companies that provide software and support called “transmitters”, “service bureaus” or software developers. The federal government regulates return preparers minimally, and only two states (California and Oregon) require preparers to be licensed. Thus, there are few barriers for fringe financial providers to become tax preparers.

The problems with fringe providers engaged in tax preparation include the questionable quality of preparation and the inadequacy of privacy protection. While transmitters can provide software and back office support, often the retail salesperson at the fringe preparer is actively engaged in the tax preparation. The fringe preparer may ask the taxpayer the important questions, gather the documentation, and enter it into the computer. For example, TaxMax provides used car dealers with a tax questionnaire that asks detailed questions about qualifications for the EITC such as “Was EIC Denied Last Year or Did You Receive an IRS Request to Qualify Your Childs Residency. If Yes Was Form 8862 or 8836 Completed to Qualify.”

Since Washington State requires outlets that facilitate the sale of RALs to register with the Department of Financial Institutions, it is easy to see the expansion of RAL lending from traditional tax preparers to payday loan stores. As of February 27, 2008, there were 611 registered RAL facilitators in Washington, including tax preparation companies and accounting services. Included on the list are 101 Advance America outlets and 60 MoneyTree stores that offer tax preparation and RALs through TaxOne’s remote service. Other Washington fringe financial service providers that market RALs include 18 Rent-a-Center CashAdvantEdge services and two offices of payday lender Til Payday Inc.

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<sup>132</sup> See [www.rcbral.com/](http://www.rcbral.com/).

<sup>133</sup> See [www.refund-advantage.com](http://www.refund-advantage.com).

<sup>134</sup> See, e.g., *Bohjanen v. Harwood State Bank (In re Bohjanen)*, 365 B.R. 916 (D.N.D. 2006).

<sup>135</sup> Stephens Inc., “*Consumer Finance*” *Industry Note*, March 5, 2008.

Another problem with fringe financial outlets is that they aggressively promote fast tax “refunds”. Rent-a-Center urged customers to bring their latest pay stub, starting on December 15 to get the “earliest estimate of your tax refund available,” and to come back January 2 or later with a W-2 to file “your *simple tax refund* quickly and easily, and you could walk out with your refund loan in minutes, if you qualify”<sup>136</sup>. A check casher in Oakland, CA offers tax preparation services provided by a KWIK Tax Services staffer at a corner table. Tax preparation costs \$100 with a \$25 discount coupon and RALs are provided by SBBT.<sup>137</sup>

Small installment lenders also offer tax preparation services during tax season. Sun Loan Company, with outlets in several western states, offers Electronic Tax return filing and RALs, partnering with “a large tax preparation company” to help its employees keep up with tax changes. Sun claims that a RAL is “the fastest method for receiving money based upon the federal tax refund.”<sup>138</sup>

Dollar Financial Group’s chain of payday loan/check cashing stores, called Money Mart, also offers tax related services. These include tax check cashing, tax preparation, e-filing, RALs and Instant RALs, Refund Transfer Checks, and “Protection Plus.” Money Mart promises to “Turn your refund into fast cash! With a RAL for \$200 to \$9,500 by check in one to three days or an instant RAL for up to \$1,700 with the balance of funds payable with a RAL in one to three days.” The Refund Transfer Check is touted as faster than an IRS paper check and results in no out-of-pocket fees for preparation and e-filing.<sup>139</sup> Money Mart tax preparation and tax check cashing customers are automatically entered in a sweepstakes to win the amount of the tax return or tax check up to \$2,500.<sup>140</sup>

ACE Cash Express, a major check casher/payday lender, promotes tax preparation in-store and online. In-store, customers are urged to apply for a RAL and cash the refund check at ACE. ACE is also promoting a contest to win a prize if the customer loads the tax refund or RAL onto NetSpend’s prepaid debit card. If the customer loads \$250 onto the NetSpend card, the card is “free.”<sup>141</sup> ACE also promotes using TurboTax to prepare taxes online and urges that the tax refund check be cashed at ACE.

Software providers/transmitters also encourage check cashers to become direct deposit providers to unbanked customers to handle Social Security and state benefit payments, payroll, and tax refunds. Petz Enterprises, Inc. (Petz) advertises its Tax Software and Financial Products or “QuickAccess” to check cashers, noting that “you get to keep a percentage of every transaction.”<sup>142</sup> Petz offers web-based tax preparation to

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<sup>136</sup> [www.cashadvantaged.com/site/page/pg3092.html](http://www.cashadvantaged.com/site/page/pg3092.html), visited March 19, 2008.

<sup>137</sup> Electronic communication from Jennie Mollica, Making Connections Oakland, received February 11, 2008.

<sup>138</sup> [www.sunloan.com/taxreturns.asp](http://www.sunloan.com/taxreturns.asp), visited February 27, 2008.

<sup>139</sup> [www.moneymart.com/MM/tax.asp](http://www.moneymart.com/MM/tax.asp), visited March 19, 2008.

<sup>140</sup> [www.moneymart.com/MM/marchcontest.asp](http://www.moneymart.com/MM/marchcontest.asp), visited March 19, 2008.

<sup>141</sup> [www.acecashexpress.com/ss\\_taxprep.php](http://www.acecashexpress.com/ss_taxprep.php), visited March 19, 2008.

<sup>142</sup> Quick Access ad, *Checklist*, Winter 2007, at 31.

check cashers as well as direct deposit accounts. Petz takes \$10 from every tax return delivered as a RAL, IRAL or RAC.<sup>143</sup> Instead of receiving tax refund checks in the mail, Quick Access customers come to the partner check casher to pick up and cash the direct deposited check.<sup>144</sup>

Software providers are also recruiting tax offices to become payday lenders. OrrTax Software Solutions is marketing Xpress Cash as an opportunity for “year-round revenue!” for tax preparers, by offering payday loans to their tax clients. The sample financial estimate claims \$32.50 in profits out of the \$45 charged for a \$300 two-week loan, which translates into an APR of 390%. Xpress Cash notes that the average payday loan customer receives 7 to 9 loans per year for average annual profit per customer of \$248.<sup>145</sup>

## *2. Payday Lenders Partner with Block to Expand into Tax Preparation and RALs*

H&R Block has quietly joined with payday lenders and other fringe financial service providers to provide tax preparation services and RALs from SBBT. TaxOne is accessed at storefront outlets where consumers bring their tax documents and a completed questionnaire to be faxed or scanned for electronic delivery to TaxOne. Tax returns are prepared by a nearby Block office and returned to the store where the consumer completes the transaction. Although H&R Block’s name appears nowhere on the TaxOne website or on materials available at partner storefronts, company officials acknowledged that TaxOne is a Block product.

According to TaxOne’s website, the ANEW RAL costs \$30.95 for account set-up and a finance charge based on the size of the loan. For a \$2,700 loan, the finance charge is listed at about \$28. If a check is printed to deliver the loan, an additional \$10 fee applies. This is similar to the fee structure used by Block for its own RALs. If a TaxOne user wants an instant RAL, there is an additional surcharge of \$39.<sup>146</sup>

The TaxOne website touts access at over 3,000 outlets, including Advance America, the largest chain of payday lenders in the country; Money Tree, a check cashing/payday loan chain based in Washington State; Check Into Cash; and some Check ‘n Go payday loan outlets.<sup>147</sup> Check Into Cash promotes TaxOne’s ANEW RAL, claiming that customers will get cash within 24 to 48 hours and save more than \$60 over what was paid last year. The lender goes on to urge borrowers to “Go wild. Buy yourself something nice.”<sup>148</sup> TaxOne’s cost reduction claims are based on a comparison to RALs offered in 2007 through an affiliated company, TaxWorks. The ANEW RAL can be deposited onto Block Bank’s ANEW prepaid debit card, direct deposited into the taxpayer’s bank account, or delivered by check.

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<sup>143</sup> [www.petz.com/vtax/pricing.asp](http://www.petz.com/vtax/pricing.asp), visited March 19, 2008.

<sup>144</sup> [www.petz.com/quickaccess/features.com](http://www.petz.com/quickaccess/features.com), visited March 19, 2008.

<sup>145</sup> [http://www.orttax.com/pdfs/ERO\\_Flyer\\_Orrtax%20-%20FINAL.pdf](http://www.orttax.com/pdfs/ERO_Flyer_Orrtax%20-%20FINAL.pdf), visited March 24, 2008.

<sup>146</sup> [www.taxone.com/faq.aspx](http://www.taxone.com/faq.aspx), visited December 17, 2007.

<sup>147</sup> [www.checkintocash.com/tax-one.htm](http://www.checkintocash.com/tax-one.htm), visited March 19, 2008.

<sup>148</sup> [www.checkintocash.com/tax-refund-loan.htm](http://www.checkintocash.com/tax-refund-loan.htm), visited March 19, 2008.

The TaxOne/Advance America information packet contains a three-page “client information organizer” form, which can also be downloaded from the TaxOne.com website. The taxpayer completes the questionnaire, which asks for taxpayer information, identity validation, military status, marital status, dependent information, income and expenses, child care expenses, an earned income credit checklist, and signatures. In addition to the completed form, a client is asked to bring W-2 forms; Form 1099-DIV or INT forms; Social Security number for self, spouse and dependents; copies of Mortgage Statement Form 1098; and a government issued photo ID.

No fee information for the cost of tax preparation is posted or available at the point of sale. TaxOne reviews the submitted materials, estimates the refund amount, and quotes a fee for tax preparation. According to company officials, the taxpayer can refuse to pay for tax preparation and walk away from the transaction after learning the costs and estimated refund. This was confirmed in person by a Check into Cash clerk at an outlet in Arizona.

Privacy of tax information is always a critical issue. To get tax preparation through TaxOne, a taxpayer’s personal financial information is handled by the fringe provider’s storefront employee, the Block/TaxOne preparer, and then is shared with SBBT if the consumer elects to use a bank product. The TaxOne folder promises that the process is “highly secure.” The brochure also promises: “Rest assured, your taxes are in good hands with TaxOne. Our sophisticated online system helps keep your personal information safe and secure.” The TaxOne website provides a privacy policy and notes that information cannot be shared without the taxpayer’s consent.

We obtained a copy of TaxOne’s privacy policy and Customer Service Agreement. The consent form required under IRS regulations to share tax return information is issued by Check into Cash, Inc. to authorize sharing tax return information with ServiceWorks, Inc. d/b/a TaxOne.<sup>149</sup> At the point of offering a RAL, presumably TaxOne would provide another consent form for the taxpayer to consent to sharing information with SBBT.

The TaxOne program may provide benefits to consumers, but also poses risks. This program provides RAL at a lower price than TaxWorks’ RALs cost in prior years (and probably less than charged at storefront outlets in general). In addition to lower RAL prices, there are no document processing, e-file, or transmission fees charged. Unlike other back office providers of tax software such as TaxMax discussed above, TaxOne has set up a system that appears to require less involvement by the storefront employee in tax preparation, with a Block preparer being the primary responsible party for preparation. This may ensure better quality tax preparation.

On the other hand, Block has partnered with fringe lenders that routinely charge 400% annual interest for loans secured by unfunded checks and due in full on the borrower’s next payday. NCLC has previously criticized utilities that send their

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<sup>149</sup> TaxOne and Check into Cash forms on file with CFA.

customers to payday lenders for electronic bill payment.<sup>150</sup> In this instance, a major tax preparer has partnered with payday lenders to market tax preparation and RALs. Typically the demand for payday loans drops during tax refund season. By partnering with TaxOne, payday loan chains keep their customers coming through the doors.

### 3. Car Dealers Leverage Tax Refunds for Down Payments

Car dealers are another type of business attracted to tax preparation. Car dealers benefit when tax refunds provide the funds for down payments on cars. For example, Ohio car dealer Serpentine advertised: “Don’t do your taxes this year...I’ll do them for you and I’ll double your refund. Use it towards your down payment on a new or used car at Serpentine Chevrolet.”<sup>151</sup> Another example is CarBiz, a dealer in Florida, which provides tax preparation on-site for a fee of \$119 and uses a RAL to finance car purchases or increase the size of a down payment.<sup>152</sup>

At CarBiz, tax preparation services are provided by Florida-based Tax Refund Services Inc (TRS), which is a transmitter that specializes in providing software and back office support to car dealers. TRS acquired two of its competitors - Tax Max and Tax Deals 4 Wheels - in recent years, and claims to be the leading tax refund consultant with over 3,000 car dealers in its national portfolio.<sup>153</sup> Despite the fact that the major RAL banks have ceased making pre-season RALs, TRS promotes a form of paystub lending called the 4<sup>th</sup> Quarter Sales Program.<sup>154</sup> This program aids dealers in selling cars in October, November and December based on expected tax refunds when customers receive their W-2s in January. Borrowers sign a promissory note and agree to apply their tax refund to the down payment on a car.

TRS claims that over half of taxpayers spend their entire tax refund in 48 hours and that selling tax refund services at a dealership will increase the size of down payments by \$1,000 to \$5,000 per deal. Besides selling more cars with larger down payments, the TRS service permits up to \$99 per tax return for the dealer, which can be collected from the consumer for “organizing the tax documents.”<sup>155</sup> TRS offers to electronically transfer funds from the taxpayer’s tax refund directly into the dealer’s bank account. If a check is used, the consumer signs the check over to the dealer. TRS charges the taxpayer \$139 which is deducted from the tax refund or loan while the RAL lender charges bank fees ranging from \$49 for a \$499 loan to \$119 for \$5,000.<sup>156</sup>

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<sup>150</sup> Rick Jurgens, *Utilities And Payday Lenders: Convenient Payments, Killer Loans*, National Consumer Law Center, June 2007.

<sup>151</sup> Advertisement on file with Consumer Federation of America.

<sup>152</sup> Brian Neill, *Fast-Cash Tax Returns Come with Price*, Bradenton Herald, February 1, 2008.

<sup>153</sup> [www.taxrefundsolutions.com/Site/TRSTaxMas/AboutUs.aspx](http://www.taxrefundsolutions.com/Site/TRSTaxMas/AboutUs.aspx), visited March 19, 2008.

<sup>154</sup> [www.taxrefundsolutions.com/Site/TRSTaxMas/FourthQuarterSalesProgram.aspx](http://www.taxrefundsolutions.com/Site/TRSTaxMas/FourthQuarterSalesProgram.aspx), visited March 23, 2008.

<sup>155</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMas/Benefits.aspx>, and [www.taxrefundsolutions.com/Site/TRSTaxMas/FAQ.aspx](http://www.taxrefundsolutions.com/Site/TRSTaxMas/FAQ.aspx), visited March 19, 2008.

<sup>156</sup> [www.taxrefundsolutions.com/Site/TRSTaxMas/HowItWorks.aspx](http://www.taxrefundsolutions.com/Site/TRSTaxMas/HowItWorks.aspx), visited March 19, 2008.

### **PART III. REGULATION, ENFORCEMENT AND LITIGATION**

#### **A. RAL Legislation**

Three states enacted laws regulating RALs, including the second law in the nation that caps RAL rates. Unfortunately, that law was immediately challenged by a RAL lender and struck down.

##### *New Jersey*<sup>157</sup>

New Jersey enacted a law regulating RAL facilitators. The new law requires facilitators to comply with the New Jersey Licensed Lenders Act, its criminal usury cap, and general usury law. Since these laws limit the interest rate on small loans to 30% APR, it prohibits tax preparers from facilitating RALs over that limit. Three days after Governor Corzine signed the New Jersey RAL law into effect, Pacific Capital Bank, the parent of SBBT, sued to stop the law's enforcement. The New Jersey federal district court held that the law was preempted by the National Bank Act.<sup>158</sup>

In addition to the rate cap, the New Jersey law contains a mandatory warning on RALs in 14-point type and various prohibitions for RAL facilitators in their role as tax preparers.

##### *Tennessee*<sup>159</sup>

Tennessee enacted a statute primarily focused on disclosures. The statute requires that RAL advertising conspicuously disclose that a RAL is a loan and that a fee will be charged. It also requires that RAL fees be posted in a 16 by 20 inch document in 28 point type, as well as provided in a written document provided to the consumer. Finally, the Tennessee law provides for a one-day right to rescind the loan; however, in that case, the consumer can still be charged a fee for a RAL.

##### *Texas*<sup>160</sup>

Texas enacted a statute which requires registration of RAL facilitators with the Office of the Consumer Credit Commissioner.<sup>161</sup> In addition, it requires a RAL facilitator to be primarily involved in tax preparation or financial services and be authorized as an e-file provider with IRS. The Texas law also requires disclosure of (1) a RAL fee schedule; (2) a RAL is a loan; (3) the taxpayer can file a return without a RAL; (4) statement that the consumer is responsible for repaying the RAL if the IRS does not issue the expected tax refund; (5) any fee that will be charged if the loan is not approved; (6) the average time for different options for refund delivery; (7) the estimated cost of the RAL and APR and (8) estimated

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<sup>157</sup> N.J. State. §§17:11D-1 to 17:11D-7.

<sup>158</sup> Pacific Capital Bank, N.A. v. Milgram, 2008 WL 700180 (D.N.J. Mar. 13, 2008).

<sup>159</sup> Tenn. Code §§ 62-29-201 to 62-29-205.

<sup>160</sup> Tex. Fin. Code §§ 350.001 to 350.008.

<sup>161</sup> That office issued regulations at Tex. Admin. Code §§ 87.102 to 87.107.

date for receiving the RAL. There are no mandatory language or font requirements.

The Texas law unfortunately preempts the San Antonio RAL ordinance, which had stronger disclosures in that it required them to be provided both in 14 point type and orally. Furthermore, the oral disclosures were required to be made in the language understood by the taxpayer.

Texas law also requires that a facilitator who advertises RALs in Spanish must offer Spanish-language disclosures and loan documents. SBBT has informed its preparers that it will not be providing Spanish-language documents.<sup>162</sup>

Thus, there are currently a total of 13 states regulating RALs:

- California<sup>163</sup>
- Connecticut<sup>164</sup>
- Illinois<sup>165</sup>
- Minnesota<sup>166</sup>
- Nevada<sup>167</sup>
- New Jersey
- North Carolina<sup>168</sup>
- Oregon<sup>169</sup>
- Tennessee
- Texas
- Virginia<sup>170</sup>
- Washington State<sup>171</sup>
- Wisconsin<sup>172</sup>

In addition, New York City has a RAL ordinance,<sup>173</sup> which it amended this past year to provide for additional disclosures.<sup>174</sup> With the exception of the Connecticut and New Jersey laws, these laws primarily rely on disclosure to protect consumers from RAL

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<sup>162</sup> Santa Barbara Bank & Trust, *Update*, Jan. 11, 2008.

<sup>163</sup> Cal. Bus. & Prof. Code § 22251 *et seq.*

<sup>164</sup> Conn. Gen. Stat. § 42-480(d) and (e). This law was successfully challenged in federal District Court as preempted by the National Bank Act. *Pacific Capital Bank, N.A. v. Conn.*, 2006 WL 2331075 (D. Conn. Aug. 10, 2006). The case is now on appeal in the Second Circuit.

<sup>165</sup> Ill. Comp. Stat. Ann. ch. 815, § 177/1, *et seq.*

<sup>166</sup> Minn. Stat. § 270C.445.

<sup>167</sup> Nev. Rev. Statutes, Title 52, §§ 2 to 18.

<sup>168</sup> N.C. Gen. Stat. §§ 53-245 to 53-254.

<sup>169</sup> Ore. Rev. Stat. 673.605.

<sup>170</sup> Va St. § 6.1-474.

<sup>171</sup> Revised Code of Washington § 19.265.010 *et seq.*

<sup>172</sup> Wis. Stat. §§ 421.301 and 422.310.

<sup>173</sup> Section 20-739 of the Administrative Code of the City of New York.

<sup>174</sup> Press Release, *Mayor Bloomberg Signs Legislation Strengthening Consumer Protection in Tax Preparation Industry*, Office of the Mayor of New York City, Mar. 15, 2007.

abuses. A few laws require registration, which may help regulate some fringe preparers who facilitate RALs. We have seen that disclosures are limited in their effectiveness in addressing the problem of RALs.

Bills that would cap RAL interest rates have been introduced in Arizona,<sup>175</sup> New York,<sup>176</sup> Ohio,<sup>177</sup> Pennsylvania,<sup>178</sup> and Vermont.<sup>179</sup> A bill was introduced in Montana that would prohibit tax preparers from charging a fee for a RAL over 36% APR.<sup>180</sup> Oregon introduced a bill capping the fees a facilitator can charge for arranging a RAL.<sup>181</sup> Disclosure only bills were introduced in Michigan<sup>182</sup> and Mississippi.<sup>183</sup>

In Washington State, a bill was introduced that would have weakened that state's RAL law by permitting registered RAL facilitators to subcontract with retail outlets (including fringe providers such as payday loan stores) to facilitate RALs.<sup>184</sup> That bill was subsequently withdrawn.

On the federal level, the full House passed the Taxpayer Protection Act of 2007, which would have simply prohibited the IRS from providing the Debt Indicator in connection with RALs that the Treasury Secretary determines to be predatory based on practices and fees charged.<sup>185</sup> Of course, the IRS already has the authority to shut down the Debt Indicator and has adamantly refused to do so for years. Senators Bingaman, Akaka and others again introduced the Taxpayer Protection and Assistance Act,<sup>186</sup> which had previously passed out of Senate Finance Committee.<sup>187</sup> This bill would require registration of RAL providers, better disclosures, and funding for free tax preparation programs and bank account pilot programs to receive refunds. It also would eliminate the Debt Indicator.

Senator Daniel Akaka re-introduced the Taxpayer Abuse Prevention Act (TAPA).<sup>188</sup> TAPA would ban RALs made against the EITC, and is the strongest federal bill introduced to regulate RALs. Senator Akaka also re-introduced the Free Internet Filing Act, which would require IRS to provide taxpayers with the ability to file their returns for free directly with the IRS, without the need to use a third party intermediary.<sup>189</sup>

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<sup>175</sup> H.B. 2428.

<sup>176</sup> S. 1677, A. 1794, A. 9996, A. 10025, S. 3250, S. 4185. A disclosure-only bill was introduced as well. S. 5190.

<sup>177</sup> H.B. 156.

<sup>178</sup> S.B. 335.

<sup>179</sup> H.B. 498.

<sup>180</sup> LC 1787.

<sup>181</sup> H.B. 3076.

<sup>182</sup> S.B. 446.

<sup>183</sup> H.B. 751.

<sup>184</sup> H.B. 3098.

<sup>185</sup> H.R. 1677.

<sup>186</sup> S.1219.

<sup>187</sup> See NCLC/CFA Report at 22-23.

<sup>188</sup> S. 1133.

<sup>189</sup> S. 1074.

## B. Enforcement

During 2007, a number of government agencies took enforcement actions involving RALs. In addition, we discuss updates to some government actions taken earlier.

### *DOJ Lawsuits against Jackson Hewitt*

In April 2007, the U.S. Department of Justice sued five Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. This lawsuit is discussed in Section I.E. above.

### *California Attorney General Actions*

The California Attorney General filed a lawsuit against Jackson Hewitt in January 2007, alleging that Hewitt made misleading statements in its promotion of its RAL and RAC programs. The California Attorney General also challenged Hewitt's cross-lender debt collection practices and alleged violation of IRS privacy rules regarding sharing of information for cross-marketing. Hewitt agreed to enter into a settlement with the Attorney General, promising reforms of its practices and paying \$4 million in consumer refunds plus \$1 million in penalties and costs.<sup>190</sup>

The California Attorney General brought a similar lawsuit against Liberty Tax Service in July 2007.<sup>191</sup> It had brought an earlier lawsuit against H&R Block in February 2006.<sup>192</sup>

### *New Jersey Attorney General Lawsuit*

The New Jersey Attorney General's Office sued a local tax preparation chain for deceptive advertisement of RALs.<sup>193</sup> The lawsuit alleged that Malqui Corporation misrepresented RALs as tax refunds, and did not disclose that they were loans. The lawsuit also alleged that Malqui failed to clearly tell consumers about the high interest rates and fees for RALs.

In addition, the New Jersey Attorney General's Office defended the state's recently enacted law regulating RALs, which required compliance with that

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<sup>190</sup> Judgment, *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Sup. Ct. Alameda Cty Jan. 3, 2007), available at [http://ag.ca.gov/cms\\_pdfs/press/2007-01-03\\_Jackson\\_Hewitt\\_Settlement\\_Judgment.pdf](http://ag.ca.gov/cms_pdfs/press/2007-01-03_Jackson_Hewitt_Settlement_Judgment.pdf).

<sup>191</sup> Complaint, *California v. JTH Tax, Inc.*, Case No. CGC-07-460778 (Cal. Super. Ct. Feb. 26, 2007)

<sup>192</sup> *People of California v. H&R Block*, 2006 WL 2669045 (N.D. Cal. Sep. 18, 2006).

<sup>193</sup> Press Release, *State Sues Tax Preparation Firm Over Deceptive "Fast Refund" Offers*, New Jersey Attorney General's Office, March 5, 2007.

state's small loan rate cap of 30%.<sup>194</sup> Pacific Capital Bank successfully challenged that law as preempted under the National Bank Act, discussed in Section III.A.

#### *New York State Division of Human Rights*

The New York State Division of Human Rights sued both Jackson Hewitt and Liberty Tax Service for discriminatory targeting of minorities for RALs, in violation of that state's Human Rights Law.<sup>195</sup> The same agency investigated Block for similar violations, but Block struck back preemptively by seeking to stop the investigation.<sup>196</sup> That effort failed, with a court holding that federal law did not prohibit the New York agency from investigating Block.<sup>197</sup>

#### *Maryland Commissioner of Financial Institutions*

In 2005, the Maryland Commissioner of Financial Institutions issued an advisory, warning tax preparers who assisted Maryland taxpayers in obtaining RALs that they were operating as a credit services organization (CSO), and that they must be licensed and comply with Maryland's CSO law.<sup>198</sup> The Commissioner of Financial Institutions subsequently began investigating tax preparers for violations of this law. In response, H&R Block sued the Commissioner alleging that it did not need to comply with Maryland's CSO law because the company is serving as an agent of a national bank when it facilitates RALs, and thus exempt from state regulation under the National Bank Act.<sup>199</sup> That litigation is still pending.

#### *North Carolina Commissioner of Banks*

The North Carolina Commissioner of Banks took enforcement action against Jackson Hewitt over its pay stub RAL program. North Carolina law prohibits RAL facilitators from using the proceeds of a RAL to pay off other debt. The NC Commissioner alleged that Hewitt's pay stub RAL practices violated this law.<sup>200</sup>

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<sup>194</sup> Complaint, Pacific Capital Bank, N.A. v. Milgram, Case No. 3:08-cv-00223 (D.N.J. Jan. 14, 2008).

<sup>195</sup> Complaint, New York State Division of Human Rights v. Jackson Hewitt, Jan 17, 2008; Complaint, New York State Division of Human Rights v. JTH Tax, Inc, Jan 17, 2008. *See also* Nicholas Confessore, *State Makes Bid to End Costly Tax-Refund Loans*, New York Times, January 18, 2008.

<sup>196</sup> Nicolas Zimmerman, *H&R Block Aims to Block Loan-Records Subpoenas*, Watertown Daily Times, April 29, 2007.

<sup>197</sup> Decision/Order, New York State Division of Human Rights v. H&R Block Tax Services, Index No. 1726/2007 (Mar. 6, 2008).

<sup>198</sup> Maryland Commissioner of Financial Regulation, *Refund Anticipation Loans/Rapid Refund Program Advisory 05-01*, January 24, 2005.

<sup>199</sup> Rachel Sams, *Block Sues Maryland Regulator Over Loan Investigation*, Kansas City Business Journal, July 23, 2007.

<sup>200</sup> Press Release, *Jackson Hewitt Agrees to \$150,000 Penalty Related to Tax Refund Loans*, North Carolina Office of the Commissioner of Banks, July 10, 2007.

Hewitt settled the case by agreeing to pay a penalty of \$150,000.<sup>201</sup> The NC Commissioner also issued its own state report on RALs.<sup>202</sup>

*New York City Department of Consumer Affairs*

The New York City Department of Consumer Affairs conducted a six-week investigation of 300 tax preparation firms over RAL advertising. As a result, DCA issued 500 citations to preparers for violations including misleading or illegal advertisements in newspapers, and misrepresenting RALs to their clients. DCA's citations represent a 75 percent increase from the previous tax year.<sup>203</sup>

C. Other Regulatory Activity

The National Taxpayer Advocate once again tackled RALs in her annual Report to Congress.<sup>204</sup> This year, she focused on the issue of the role of RALs in creating incentives for tax fraud, the subject of the IRS rulemaking discussed in Section I.E.

U.S. Senators Charles Grassley and Charles Schumer issued a press release warning payday and RAL lenders not to make loans secured by the stimulus tax rebates that Congress approved in February 2008.<sup>205</sup> Senators Grassley and Schumer also sent letters to the major RAL providers and payday lenders with the same warning. The IRS has stated that the stimulus rebate payments will be sent in the form of paper checks to taxpayers who took out RALs or RACs during the 2008 tax season. Generally, stimulus payments will be sent by direct deposit if the taxpayer selected that method for his or her 2007 refund, but since RACs and RALs use a dummy bank account, the IRS decided not to deposit stimulus payments into those accounts. This decision also ensures that RALs will not be made against these payments.

A multitude of elected officials and government agencies issued warnings or advisories to consumers to avoid RALs, including:

U.S. Senator Charles Schumer<sup>206</sup>  
North Carolina Governor Mike Easley<sup>207</sup>  
Illinois Lieutenant Governor<sup>208</sup>  
Arkansas Attorney General<sup>209</sup>

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<sup>201</sup> *Id.*

<sup>202</sup> North Carolina Office of the Commissioner of Banks, *Report on Tax Refund Loans*, Apr. 24, 2007.

<sup>203</sup> *NYC Cracks Down on 'Instant Tax Refund' Practices*, *Newsday*, Feb. 21, 2008.

<sup>204</sup> National Taxpayer Advocate, *FY 2007 Annual Report to Congress*, December 31, 2007, at 83.

<sup>205</sup> Press Release, *Grassley, Schumer Warn Payday Lenders: Stay Away From Americans' Rebate Checks*, Feb. 11, 2008.

<sup>206</sup> Press Release, *Sen. Schumer Warns of Tax Refund Scams That Cheat Hundreds of Thousands of Upstate New Yorkers Out of Millions of Dollars*, Office of Sen. Charles E. Schumer, Jan. 16, 2007.

<sup>207</sup> *Don't Borrow Trouble: Advances on Tax Refunds are Loans You Don't Need*, *Charlotte Observer*, Jan. 21, 2007.

<sup>208</sup> Press Release, *Lt. Gov. Quinn Promotes State-Funded Tax Advice Centers, Encourages Taxpayer to Avoid Costly Refund-Anticipation Loans*, Office of Lt. Gov. Pat Quinn, Feb. 8, 2007.

<sup>209</sup> *McDaniel Warns Taxpayers of Refund Anticipation Loans*, *Arkansas News Bureau*, Feb. 24, 2007.

Illinois Attorney General<sup>210</sup>  
Iowa Attorney General<sup>211</sup>  
Minnesota Attorney General's Office<sup>212</sup>  
Nevada Attorney General<sup>213</sup>  
New Jersey Attorney General<sup>214</sup>  
North Dakota Attorney General<sup>215</sup>  
Georgia Office of Consumer Affairs<sup>216</sup>  
Massachusetts Office of Consumer Affairs and Business Regulation<sup>217</sup>  
Michigan Department of Labor and Economic Growth<sup>218</sup>  
Oklahoma Dept. of Consumer Credit<sup>219</sup>  
South Carolina Department of Consumer Affairs<sup>220</sup>  
Chicago Department of Consumer Services<sup>221</sup>

#### D. Litigation

The following is a summary of case developments in lawsuits involving RALs and related matters.

##### *Credit Services Organization Cases*

Several cases were filed against Jackson Hewitt for violation of state Credit Services Organization Act laws. These laws regulate both credit repair organizations and “any person or organization who assists or offers to assist consumers in obtaining an extension of credit,”<sup>222</sup> which should include tax preparers who offer to arrange RALs. Similar lawsuits had been filed against

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<sup>210</sup> *Costly Credit: Refund Anticipation Loans and Universal Default*, Illinois Attorney General's Office, Feb. 2007.

<sup>211</sup> Consumer Advisory, *Rapid Tax-Refund Loans*, Iowa Attorney General's Office, Jan. 2007.

<sup>212</sup> *Beware of Instant Tax Refund Loans*, Minnesota Attorney General's Office.

<sup>213</sup> Press Release, *Attorney General Masto Warns of Costly Tax Refund Loans*, Nevada Attorney General's Office, Apr. 10, 2007

<sup>214</sup> Press Release, *Know the Facts Before Agreeing to a Refund Anticipation Loan*, New Jersey Attorney General's Office, Feb. 14, 2008.

<sup>215</sup> *Refund Anticipation Loans, Too Good to Be True....*, North Dakota Attorney General's Office, Jan. 2, 2008.

<sup>216</sup> Press Release, *Refund Anticipation Loans: Are They Worth It?* Georgia Office of Consumer Affairs, March 5, 2007.

<sup>217</sup> *Don't Borrow Your Own Money! Consumer Affairs Advises Tax Payers to Steer Clear of Tax Refund Anticipation Loans*, Massachusetts Office of Consumer Affairs and Business Regulation, January 29, 2008.

<sup>218</sup> Press Release, *Office of Financial and Insurance Services Warns Taxpayers to Steer Clear of Tax Refund Loans*, March 14, 2007.

<sup>219</sup> *Consumer Officials Warn Taxpayers of Refund Loans*, Oklahoman, Jan. 17, 2007.

<sup>220</sup> Press Release, *Truth About Tax Refund Anticipation Loans*, South Carolina Dept of Consumer Affairs, Jan. 16, 2007.

<sup>221</sup> Press Release, *Department of Consumer Services Cautions Consumers About Costs of 'Instant' Tax Refunds*, Chicago Department of Consumer Services, Jan. 22, 2007.

<sup>222</sup> A full explanation of these laws and their remedies is discussed in NCLC, Fair Credit Reporting, § 15.1.3 (6th ed. 2006 and Supp.).

H&R Block, which were settled in 2005.<sup>223</sup> Lawsuits against Hewitt for violation of CSOA laws include

- Brown v. Jackson Hewitt, Inc., 2007 WL 642011 (N.D. Ohio Feb. 27, 2007) (granting motion to remand case from federal court to state court)
- Hunter v. Jackson Hewitt, Inc., 2008 WL 706788 (S.D. W.Va. Mar. 13, 2008) (granting summary judgment on consumer's claim for breach of contract).

#### *Fallout from Jackson Hewitt Fraud Cases*

At least two class actions were filed by Jackson Hewitt customers who alleged that Hewitt preparers included false information on the customers' returns without the customers' knowledge.<sup>224</sup> These lawsuits alleged violation of state consumer protection laws and the Racketeer and Corrupt Organizations Act. In addition, the lawsuits alleged that the customers were sold "Gold Guarantee" products, which would reimburse them for additional tax liability caused by a Hewitt tax preparer's error. The customers' claims for reimbursement were denied, supposedly in violation of their Gold Guarantee contracts.

#### E. Advocacy

In April 2007, consumer groups organized a letter that was sent to every member of Congress outlining a RAL Reform Agenda. This letter was sent on behalf of about 70 consumer, civil rights, free tax preparation, and advocacy groups. The RAL Reform Agenda advocated for:

- A ban on RALs made against the EITC
- Regulation of tax preparers
- Funding for free tax preparation programs
- Support for bringing unbanked consumers into the financial mainstream
- The ability for taxpayers to file electronically directly with the IRS

A coalition of local and state consumer advocacy groups continued their coordinated campaign against RALs. These groups included the California Reinvestment Coalition (CRC), Woodstock Institute, Neighborhood Economic Development Advocacy Project (NEDAP), and the Community Reinvestment Association of North Carolina (CRA-NC).

The coalition of local and state consumer groups met with SBBT in October 2007. They also met with the Comptroller of Currency in January 2007 over the issue of pay stub and holiday RALs. NCLC, CFA, the coalition, and other national consumer groups sent a letter to the Office of Comptroller of Currency asking the OCC to stop HSBC, SBBT and Chase from making pay stub/holiday RALs.

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<sup>223</sup> NCLC/CFA 2006 RAL Report at 25-26; NCLC/CFA 2005 RAL Report at 26.

<sup>224</sup> Complaint, Chapman v. Jackson Hewitt, Inc., Civ. No. 07-2910 (D.N.J. June 22, 2007); Complaint, Wooley v. Jackson Hewitt Tax Service, Inc., Case 07-cv-02201 (N.D. Ill. Apr. 20, 2007).

Free tax preparation programs across the country continue to provide low-cost alternative RALs, including Alternatives Credit Union in Ithaca, NY, AccountAbility Minnesota, and the San Antonio City Employees Credit Union.<sup>225</sup>

The coalition of local and state consumer groups, as well as other advocacy organizations, issued reports on RALs, including:

- Chris Keeley, Sarah Ludwig and Mark Winston Griffith, *Predatory Tax-Time Loans Strip \$324 Million From New York City's Poorest Communities: An Analysis of Tax Refund Anticipation Lending in NYC 2002 – 2005*, Neighborhood Economic Development Advocacy Project, January 2007, available at <http://www.nedap.org/documents/FINAL2007NEDAPRALsreport.pdf>.
- Peter Skillern and Adam Rust, *The High Cost of Refund Anticipation Loans in North Carolina*, CRA-NC, January 25, 2007, available at <http://www.cra-nc.org/New%20web%20content/2006%20RALReport01.pdf>.
- Tom Feltner, *Refund Anticipation Loan Lending in the Chicago Region*, Woodstock Institute, January 2007, available at <http://www.woodstockinst.org/publications/download/refund-anticipation-loan-lending-in-the-chicago-region/>.
- Rhea Serna, *Tax Refund Anticipation Loans Rip-Off Low-Income Families*, California Reinvestment Coalition, February 6, 2007, available at <http://www.calreinvest.org/news-room/2007-02-06>.
- David Rothstein, *EITC Gains, RAL Drains: The widespread use of the Earned Income Tax Credit throughout Ohio*, Policy Matters Ohio, February 2007, available at <http://www.policymattersohio.org/pdf/EitcGains2007.pdf>.
- ACORN Financial Justice Center, *Missing Millions: Expanding Access to the Earned Income Tax Credit While Reducing Reliance on Refund Anticipation Loans*, ACORN, January 2007, available at [http://www.acorn.org/fileadmin/ACORN\\_Reports/2007/EITC2007.pdf](http://www.acorn.org/fileadmin/ACORN_Reports/2007/EITC2007.pdf).
- *Keeping What They've Earned: Working Americans and Tax Credits*, Children's Defense Fund (March 2007) (versions for California, District of Columbia, Mississippi, New York, Ohio, South Carolina, Tennessee, and Texas), available at [http://www.childrensdefense.org/site/PageServer?pagename=tbo\\_vita](http://www.childrensdefense.org/site/PageServer?pagename=tbo_vita).

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<sup>225</sup> Aissatou Sidime, *A Lower-Cost Refund*, San Antonio Express-News, Feb. 12, 2007.