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Contacts:

NCLC: Jan Kruse (jkruse_at_nclc.org) or
Chi Chi Wu (cwu_at_nclc.org), 617-542-8010
CFA: Tom Feltner (tfeltner_at_consumerfed.org),
202-618-0310

NEW REPORT DOCUMENTS EVOLVING TAX-TIME FINANCIAL PRODUCTS MARKET
Familiar Products, New Non-bank Loans After the End of Bank Tax Refund Anticipation Loans

Download the full report: http://www.nclc.org/images/pdf/high_cost_small_loans/ral/ral-report-2013.pdf

BOSTON — As tax season shifts in to full swing, the National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) have issued their eleventh annual report on the tax-time financial products industry: *Something Old, Something New in Tax-Time Financial Products: Refund Anticipation Checks and the Next Wave of Quickie Tax Loans*.

The good news? For the first time in decades, millions of taxpayers will avoid having their refunds drained by refund anticipation loans (RALs), which are no longer available from banks on a large scale, nationwide basis. The bad news? Taxpayers are still at risk of needless fees from tax-time refund products, such as:

- RALs from fringe, non-bank lenders – Some payday and other high-cost lenders are offering RALs. These loans could be more expensive and riskier than bank RALs.
- Shady tax preparers offering phantom RALs – In 2012, some preparers promoted RALs, but apparently did not have the financial capacity to make them to a large number of customers. These RAL offers were allegedly bait-and-switch schemes to get customers into their offices.
- Refund anticipation checks (RACs) – RACs do not deliver refunds any faster than the IRS can, yet cost \$30 to \$55 delivered via check. Some preparers charge add-on fees which can range from \$25 to several hundred dollars.

“While we are glad to see the disappearance of bank RALs, consumers should avoid the other traps still out there on the market,” said Chi Chi Wu, staff attorney at the National Consumer Law Center. “They should especially steer clear of RALs made by payday lenders, which are likely to be more expensive and riskier.”

Consumer advocates suggest that taxpayers looking for quick refund cash should consider lower-cost or free alternatives. Taxpayers with a bank account can get their tax refunds in 21 or less days with e-filing and direct deposit.¹ Taxpayers without a bank account can get the same three week or less refund by e-filing and having their refund deposited to a prepaid card, including any existing payroll or prepaid card that the taxpayer already has.

¹ In previous years, taxpayers could get refunds in as little as 8 to 15 days; however, refunds will take longer this year in part due to new IRS anti-fraud measures.

Non-Bank RALs and Phantom RALs

With the end of RALs made by banks, high cost non-bank lenders have stepped into the fray. Liberty Tax Service is partnering 1st Money Center and Redpoint Capital to make non-bank RALs in about 26 states. 1st Money Center and Redpoint Capital appear to be linked with Texas payday lenders.

RALs made by nonbank lenders will most likely not be as widespread as bank RALs. Unlike banks, nonbank lenders do not have the legal ability to flout state laws that cap interest rates, *i.e.*, usury laws. Tax-time loans from payday lenders and other storefront outlets that offer to prepare taxes and make loans may be subject to state loan laws, usury caps, or loan broker requirements in states that have them. Eighteen states (and the District of Columbia) do not permit payday lending at all (for a complete listing of state payday lending laws, see www.paydayloaninfo.org/state-information).

Nonbank lenders may also lack the funding necessary to make RALs on a broad scale. One problem last year was “phantom” RAL lending, where less-than-scrupulous tax preparers claimed to have RALs but did not. For example, the U.S. Department of Justice’s lawsuit against one such preparer – Instant Tax Service – alleged that the chain promoted RALs to entice customers, but was so severely undercapitalized that its overall denial rate was often over 90%. Note that in order to make 1 million RALs, a lender would need \$1.5 *billion* in capital (assuming loans of \$1,500). Preparers allegedly used phantom RAL offers to lure customers into their offices, where some of them ended up paying \$400 to \$500 or more for tax preparation, RACs, and add-on fees.

Refund Anticipation Checks

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 check or prepaid card and closes the temporary account. A RAC allows the consumer to pay for tax preparation fees out of the refund and provides the speed of direct deposit of tax refunds for unbanked taxpayers, but generally at an additional cost.

Banks generally charge about \$30 - \$55 for a RAC delivered via check (with discounts for delivery by prepaid card or direct deposit). While this is much less than the price of a RAL, some tax preparers also charge their own add-on fees, which can range from \$25 to several hundred dollars.

Since one of their purposes is to defer payment of the tax preparation fee until the refund arrives, RACs may represent a high-cost loan of that fee. If a taxpayer pays \$30 to defer payment of a \$200 tax preparation fee for 3 weeks, the APR would be equivalent to 260%.

Prepaid cards are one alternative to allow taxpayers without a bank account to receive a faster refund. Taxpayers, however, should be cautious when selecting a prepaid card.

“As with any financial product, taxpayers should compare prepaid card costs and consumer protections,” recommends Tom Feltner, director of financial services for Consumer Federation of America. Taxpayers without a bank account should also consider opening a bank account to receive their refund. “Getting a big refund is the perfect time to open a savings account and start a nest egg,” advised Feltner.

Low-income taxpayers have a number of options for free tax preparation, including Volunteer Income Tax Assistance (VITA) (1-800-906-9887 or www.irs.gov) and AARP Tax-Aide sites (https://locator.aarp.org/vmis/sites/tax_aide_locator.jsp). Choosing a VITA or AARP Tax-Aide site saves taxpayers the cost of the tax preparation fee. Many VITA sites also offer services to help open a bank account or get a low-cost prepaid card, which enables taxpayers to get faster refunds without paying a fee. Free tax preparation may be available on military bases, and since servicemembers are required to have bank accounts, they are able to benefit from the speed of electronic delivery of their tax refunds

There are also a number of websites that allow many taxpayers to prepare and file their taxes online for free, such as the IRS Free File program (www.irs.gov).

RAL History and Data for Prior Years

RALs were bank loans secured by the taxpayer’s expected refund — loans that lasted about 7 to 14 days until the actual IRS refund repaid the loan. RALs were expensive. In 2012, the last of the RAL banks (Republic Bank) charged \$61.22 for a RAL of \$1,500, which translated into an APR of 149%.

RAL lending had dropped significantly during the last two years of their existence. In 2011, about 1 million taxpayers applied for a RAL, and National Consumer Law Center and the Consumer Federation of America estimate that 750,000 people obtained a RAL at a cost of \$46 million in loan fees. This contrasts with 2010, in which 6.85 million taxpayers applied for a RAL, and an estimated 5 million received them at a cost of \$338 million. At their height in 2002, about 12.7 million taxpayers obtained a RAL at a total cost of \$1.1 billion.

The dramatic drop in 2011 was because the three largest RAL lending banks were forced out or exited the market, leaving only three small state-chartered banks making RALs. This development also left industry giant H&R Block without a RAL lender.

Many RAL borrowers have now shifted to RACs. In 2011, the number of taxpayers receiving a RAC increased to an estimated 18.3 million, up from 14.6 million taxpayers in 2010 and 12.9 million in 2009.

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Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

The Consumer Federation of America is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.