SOMETHING OLD, SOMETHING NEW IN TAX-TIME FINANCIAL PRODUCTS:

Refund Anticipation Checks and the Next Wave of Quickie Tax Loans

The NCLC/CFA 2013 Tax-Time Financial Products Report

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By

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Executive Summary

With bank refund anticipation loans (RALs) no longer offered after the 2012 tax season, the market for tax-time financial products has been evolving. The biggest replacement for RALs are refund anticipation checks (RACs). Over 18 million consumers obtained RACS in 2011 (the last year for which the IRS has provided data).

A number of payday lenders and other non-bank businesses are making tax-time loans. These non-bank RALs may be more expensive than bank RALs. However, these non-bank RALs will not be made on the same scale as bank RALs – in the order of hundreds of thousands of loans at most, not millions.

RACs, on the other hand, remain a product sold to tens of millions of taxpayers. RACs are not as expensive or risky as RALs but do not provide a speed advantage for many consumers, and can represent a high-cost loan of the tax preparation fee. In fact, a California appellate court recently ruled, in a lawsuit brought by the California Attorney General, that a RAC is indeed a disguised loan and the fee is a finance charge. Furthermore, some preparers also charge expensive "add-on" or junk fees for RACs, which can add significantly to their cost.

Tax preparation fees also can be an area of abuse. These fees are often opaque and expensive, with taxpayers unable to obtain estimates of fees to comparison shop. Tax preparation fees should be subject to a standardized, easy-to-understand disclosure.

This report also includes historical data concerning RALs and RACs, such as:

- IRS data shows that RAL volume again declined significantly from 2010 to 2011. Tax preparers and their bank partners made approximately 750,000 RALs during the 2011 tax-filing season compared to 5 million in 2010, and a high of 12.4 million in 2004.

- Consumers paid an estimated $46 million in RAL fees in 2011 to get quick cash for their refunds, essentially borrowing their own money at extremely high interest rates. They paid $550 million in RAC fees as well in 2011.

- In addition to RAL and RAC fees, consumers in 2011 paid another estimated $152 million in add-on fees, such as "transmission," "data and document storage," and "technology" fees.

I. Overview and Updates

A. Introduction to the Tax-Time Products Market

For many low- and moderate-income Americans, tax-time is when they will receive the largest influx of money during the year. In general, over 80% of Americans receive a refund when they file their tax returns.[1] Some of these taxpayers, especially working families, will receive the Earned Income Tax Credit (EITC), a refundable credit intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, providing nearly $58 billion to nearly 26 million families in 2011.[2]

These EITC recipients, and consumers receiving substantial refunds in general, present a lucrative target for many businesses. This includes retailers, such as car dealers and furniture stores, as well as purveyors of financial products such check cashers and prepaid card issuers. More significantly, an entire industry evolved to profit off taxpayers and EITC recipients - the tax-time financial products industry.

For decades, the main product providing hefty profits to this industry was refund anticipation loans (RALs), which were loans made by banks, secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs were usually made for a duration of about seven to fourteen days (the difference between when the RAL was made and when it was repaid by deposit of the taxpayer's refund), fees for these loans could translate into triple digit annual percentage rates (APRs). From 2009 to 2011, all of the banks left the RAL market either voluntarily or because they were forced out by their regulators. Thus, 2012 was the last year in which bank RALs were made.

A related product is the refund anticipation check (RAC). 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, or makes a direct deposit, and closes the temporary account. A RAC is no faster than the direct deposit of a refund, but it allows the consumer to pay for tax preparation fees out of the refund. In the past, the IRS has stated that the direct deposit of a refund, if the return is filed electronically, generally took 8 to 15 days. This year, the IRS is advising

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[1] Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013).

[2] *Id.*

that "more than 9 out of 10 refunds to taxpayers [would be issued] in less than 21 days"[3] Apparently, refunds will take longer this year in part due to IRS anti-fraud measures.[4]

With the demise of bank RALs, a handful of non-bank lenders have begun offering tax-time loans. These include everything from RAL replacement loans offered by major tax preparation chains to tax refund "buying" that is really a disguised loan. Another variant is the "phantom" RAL, where less-than-scrupulous tax preparers claim to have RALs but do not. These RAL offers are allegedly bait-and-switch schemes to get customers into their offices.

Consumers anxious for the cash infusion received annually from tax refunds may be more vulnerable to non-bank RALs and phantom RALs this year. In addition to the longer stated timeframes for refunds, the IRS was forced to delay the start of tax season from January 22 to January 30, 2013. The delay is due to the fact that Congress did not resolve the "fiscal cliff" until New Year's Day 2013, resulting in last-minute changes to the tax code for which the IRS needed to program its computers.[5] Thus, taxpayers had even longer waits for refunds this year, making them susceptible to abuses.

For over a decade, the National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) have jointly issued annual reports on the RAL industry and the drain caused by RALs from tax refunds and EITC benefits.[6] In addition to our yearly reports, we have issued a number of special reports,[7] including three reports regarding mystery shopper testing of RAL providers.[8]

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[3] IRS, Publication 2043, IRS Refund Information Guidelines for the Tax Preparation Community (Dec. 2012).

[4] Jeff Stimpson, IRS: 21-Day Refunds Likely Again in 2013, Accounting Today, Dec. 15, 2012, *available at* http://www.accountingtoday.com/news/IRS-21-Day-Refunds-Likely-Again-in-2013-65012-1.html.

[5] Michael Cohn, IRS Delays Tax Season until End of January, Accounting Today, Jan. 8, 2013, http://www.accountingtoday.com/news/IRS-Delays-Tax-Season-End-January-65284-1.html.

[6] These reports are all available at www.nclc.org/issues/refund-anticipation-loans.html. The first of these reports, which includes the most comprehensive look at the RAL industry, was Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, National Consumer Law Center and Consumer Federation of America, Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury (Jan. 31, 2002), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/ral/2002-ral-report.pdf [hereinafter NCLC/CFA 2002 RAL Report].

[7] Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom (Nov. 2008), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/ral/paystub_ral_report.pdf.; Chi Chi Wu, National Consumer Law Center, Corporate Welfare for the RAL Industry: the Debt Indicator, IRS

B. Refund Anticipation Checks

With the demise of RALs, refund anticipation checks have become the dominant tax-time financial product on the market. According to the latest IRS data, about 18.3 million taxpayers obtained a RAC in 2011.[9] Since most RACs cost about $30 in 2011, these taxpayers paid about $550 million.

The number of RACs increased by 26% from 2010, when 14.6 million taxpayers received these products at a cost of $438 million,[10] and by a whopping 43% from 2009, when 12.9 taxpayers received these products at a cost of $387 million.[11] The vast majority of RAC consumers – almost 85% in 2011 – are low-income.[12] About half of RAC consumers are EITC recipients.[13]

RACs present a number of issues for consumers. In the past, they have generally cost $30 to $35.[14] This year, they cost $30 to $55 delivered via check (with

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Subsidy, and Tax Fraud (July 2005), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/ral/debt_indicator_white_paper.pdf.

[8] Chi Chi Wu, Deyanira Del Rio, Alexis Iwanisziw, Peter Skillern, National Consumer Law Center, NEDAP, Community Reinvestment Association of North Carolina, Tax Time 2011: Mystery Shopper Testing In New York And North Carolina Finds Continuing Problems With Tax Preparers (Apr. 2011) [hereinafter 2011 RAL Mystery Shopper Report]; Chi Chi Wu, Michael Rowett, Peter Skillern, Deyanira Del Rio, Alexis Iwanisziw and Josh Zinner, National Consumer Law Center, Arkansans Against Abusive Payday Lending, NEDAP, Community Reinvestment Association of North Carolina, Tax Preparers Out of Compliance: Mystery Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in Arkansas, New York and North Carolina (Apr. 2010) [hereinafter 2010 RAL Mystery Shopper Report]; Chi Chi Wu, Kerry Smith, Peter Skillern, Adam Rust, and Stella Adams, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia (Apr. 2008) [hereinafter 2008 RAL Mystery Shopper Report].

[9] According to the IRS data, 18 million taxpayers applied for a RAC in 2011. Data from IRS SPEC, Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013). In addition, we estimate there were about 250,000 RAL applicants who were denied a loan, *see* Section I.D. below, which was then converted to a RAC.

[10] *See* Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, The Party's Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers 11 (Feb. 2012) [hereinafter NCLC/CFA 2012 RAL Report].

[11] *See* Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, End of the Rapid Rip-Off: An Epilogue for Quickie Tax Loans 13 (Feb. 2011) [hereinafter NCLC/CFA 2011 RAL Report].

[12] *See* Section I.F.

[13] *Id.*

[14] *See* NCLC/CFA 2011 RAL Report at 13; Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, Major Changes in the Quick Tax Refund Loan

discounts for delivery via prepaid card or direct deposit). This is less expensive than a refund anticipation loan, but still pricey for what is essentially a one-time use bank account. For 2013, sample RAC fees include:

- H&R Block charges $24.95 for a RAC delivered on an Emerald Card, $34.95 for a RAC delivered via direct deposit, or $54.95 for a RAC delivered via paper check.[15]

- Both Jackson Hewitt[16] and Liberty Tax[17] charge $29.95 for a RAC.

- River City Bank charges $30.95[18]

- Republic Bank & Trust charges $9.95 for a RAC on a prepaid card; $19.95 for a RAC delivered via direct deposit; and $31.95 for a RAC delivered by check.[19]

- EPS Financial provides a free RAC if it is deposited on the E1 Visa Prepaid Visa card; otherwise it charges $20 for direct deposit ($10 plus another $10 for a state refund) or $40 for a check ($20 plus another $20 for a state refund).[20]

In addition to the RAC fee itself, many tax preparers charge add-on fees, such as "document processing" or e-filing fees, discussed further in Section I.E. This can significantly add to the expense of a RAC. We estimate that RAC consumers paid about $140 million in add-on fees, discussed in Section I.E. This adds to the total for RACs, bringing it to almost $700 million.

Industry 8-9 (Feb. 2010) [hereinafter NCLC/CFA 2010 RAL Report]. *See also* U.S. Government Accountability Office, 2012 Tax Filing: IRS Faces Challenges Providing Service to Taxpayers and Could Collect Balances Due More Effectively, GAO-13-156, Dec 2012, at 23, *available at* http://www.gao.gov/products/GAO-13-156.

[15] Allie Johnson, Refund Anticipation Loans Live on in New Disguises, CreditCards.com, Feb. 12, 2013, *at* http://www.creditcards.com/credit-card-news/refund-anticipation-loans-not-really-gone-1273.php.

[16] Visit to Jackson Hewitt office, Prescott, AZ.

[17] JTH Holding, Inc., Transcript of Investor Day 2012 Presentation, Dec. 12, 2012 at 75, *available at* phx.corporate-ir.net/External.File?t=1&item=VHlwZT0yfFBhcmVudElEPTQ4NzE5MzB8Q2hpbGRJRD00ODg4ODc= [hereinafter "JTH Holdings, Inc., Investor Day 2012 Presentation"].

[18] River City Bank, Product Pricing, at http://www.rcbral.com/bank-product-pricing.html (visited Feb. 18, 2013).

[19] Republic Bank & Trust, Refund Transfers (RTs), at https://www.republicrefund.com/Products/Refund-Transfers.aspx (visited Feb. 18, 2013).

[20] E-Collect, EPS Financial, at http://www2.epsfinancial.net/en/solutions/e-collect (viewed Feb. 10, 2013). The E1 Prepaid Card is issued by Bancorp Bank. *See* http://www2.epsfinancial.net/en/solutions/e-collect/card-connection/e1-card-fees (viewed Feb. 10, 2013) .

Note that RACs do not have a speed advantage over a refund that is direct deposited by the IRS into the consumer's own bank account or onto a prepaid card. A taxpayer who does not have a bank account should be encouraged to open one. In addition to speeding refunds, bank accounts help taxpayers avoid paying check cashing fees.

RACs may also represent a disguised loan of the tax preparation fee. When taxpayers obtain a RAC simply because they cannot afford the price of tax preparation upfront, they are essentially paying to defer payment of the tax preparation fee—which is a loan. If a taxpayer pays $30 to defer payment of a $200 tax preparation fee for three weeks, the APR would be equivalent to 260%. A California appellate court recently held, in a case brought by the California Attorney General against Liberty Tax Service, that a RAC constitutes a loan of the tax preparation fee, and thus RAC fees are finance charges under the Truth in Lending Act. This decision is discussed further in Section III.C. The California appellate court's holding could impact RAC practices across the country.

Furthermore, by permitting the taxpayer to have the price of tax preparation deducted from the refund, RACs make taxpayers less sensitive to the price of tax preparation. The problems with lack of transparency in tax preparation fees are discussed in Section I.H.

Finally, mystery shopper testing has revealed instances in which tax preparers have automatically sold RACs to consumers, without the consumers' knowledge, consent, or full understanding.[21]

C. Non-bank RALs

With the end of RALs made by banks, high cost non-bank lenders have stepped into the fray. A number of payday lenders and other non-bank businesses are making tax-time loans. We have also seen the return of tax refund "buying," which is a disguised loan.

Some examples of non-bank RALs are:

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[21] *See* 2011 RAL Mystery Shopper Report at 5; 2008 RAL Mystery Shopper Report at 5. *See also* Benjamin Marks, Sara Dewees and Shawn Spruce, First Nations Development Institute, More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns, 2012, at 10-12; Sara Dewees, First Nations Development Institute, Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses, Apr. 15, 2011, at 11-12.

- Liberty Tax Service is partnering with 1st Money Center and Redpoint Capital to make non-bank RALs in about 26 states.[22] 1st Money Center and Redpoint Capital appear to be linked with Texas payday lenders, including the same one that Liberty partnered with last year, discussed further in Section II.C. The fees and interest charged by Liberty's lenders may vary depending on what is permitted by state small loan laws. One example comes from the blog BankTalk, which reported that Liberty charged a fee of $49.90 plus an undisclosed amount of periodic interest in North Carolina.[23] If the periodic interest rate is 36%, the borrower would pay $79.90 ($49.90 plus $30 in periodic interest) for a $2,000 loan that lasts 15 days[24] - for an APR of 97%.

- Jackson Hewitt has partnered with BillFloat to offer a pre-season open-end line of credit from $200 to $1000, discussed further in Section II.B. BillFloat charges a monthly "maintenance" fee of $6.25; an "access" fee of 3% or $10, whichever is greater, each time the consumer accesses the line; and periodic interest of 35%.[25] Thus, if the consumer has the line for 2 months and obtains a $500 extension for credit at once, she will pay $38.75. A comparable closed-end loan would have an APR of 93%.

- AIT Financial Group markets what it characterizes as an "alternative" to traditional RALs by purchasing tax refund receivables directly from the taxpayer at a discount.[26] This form of tax refund "buying" existed prior to the advent of bank RALs, and appears to be actually a disguised loan. A similar product was the subject of the Colorado Attorney General's lawsuit in State ex rel Salazer v. The Cash Now Store.[27] AIT's website gives examples of how much it will pay to purchase a tax refund. These purchases prices range from $600 for a refund of $700 to $725; $925 for a refund of $1,100 to $1,200; and $1,250 for a refund of $1,500 to $1,600.[28] For a 15-day loan at these prices, the comparable APRs are 400% to 500%; 460% to 723%; and 486% to 681%.

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[22] Liberty Tax Service, Refund and Loan Options, at http://www.libertytax.com/refund-options.html (viewed Feb. 6, 2013).
[23] Three Liberty Tax Stores, Three Business Models, BankTalk, Jan. 29, 2013, *at* http://banktalk.org/2013/01/29/three-liberty-tax-stores-three-business-models/#more-5561.
[24] The IRS states that it will deliver over 90% of refunds within 21 days. *See* Section I.A above. Industry sources suggest that the earliest a refund would be delivered is 8 days. The median amount of time for an e-filed, direct deposit refund is then 14.5 days.
[25] Jackson Hewitt, SmartLine™ Line of Credit Description and Frequently-Asked-Questions, at https://jacksonhewitt.custhelp.com/app/answers/detail/a_id/2915/~/smartline%E2%84%A2-line-of-credit-description-and-frequently-asked-questions (viewed Feb. 10, 2013).
[26]AIT Financial Group, http://www.ralreplacement.com/ProductOverview (viewed Feb. 20, 2013)
[27] 31 P.3d 161 (Colo. 2001).
[28] AIT Financial Group, FAQs, at http://www.ralreplacement.com/FAQ (viewed Feb. 12, 2013).

AIT Financial Group claims to be exempt from federal consumer protections. It also notes that its ability to purchase refunds depends on "the amount of money we have available, as well as the number of offers we receive on any given day."[29]

- ATC Income Tax offers two products, an Advance Cash Loan (ACL) and an Electronic Refund Check (ERC).[30] The ACL is similar to a refund anticipation loan and is marketed as an instant, interest-free advance based on the expected tax refund. We do not know if ATC charges a flat fee for the advance. Loans of up to $1,000 are available and must be repaid through the proceeds of the income tax refund or by other arrangements.[31] The ERC appears to be a RAC. ATC's RAL is available through ATC Income Tax's four locations in Milwaukee, Wisconsin. ATC's website does not disclose the identity of the lender for the RAL.

- iTax Advance is a lead generator marketing short-term consumer loans to taxpayers searching for RALs, RACs or refund installment loans. The company's website offers links to TurboTax free edition (available to taxpayers filing form 1040EZ) and offers referrals to lenders providing short-term loans, installment loans, and lines of credit.[32] iTax Advance provides referrals for loans of up to $1,000. No tax preparation services are provided, and iTax Advance does not require a borrower to provide any tax return information as part of the loan application. Lenders who receive referrals from iTax Advance are licensed in the states where the borrower resides and loans made to borrowers in Texas are arranged through a Credit Services Organization (CSO).[33]

- Despite being sued by the U.S. Department of Justice over its RAL practices (see below), Instant Tax Services continues to market RALs. Instant Tax markets two products: an instant tax refund loan (IRAL) and a standard tax refund loan (RAL). IRALs are advertised in amounts of $200, $300, $400 or $500 and are dispersed immediately after a tax return is prepared.[34] RALs are advertised in amounts of $300, $500 or $1000 and are dispersed 8-24 hours after a tax return is prepared.[35]

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[29] *Id.*
[30] http://www.atc1040.com/sub.php?page=products_services (viewed Feb. 4, 2013).
[31] *Id.*
[32] http://www.itaxadvance.com/ (visited Feb. 18, 2013).
[33] *Id.*
[34] http://www.instanttaxservice.com/instant-refund-anticipation-loan-IRAL.php (viewed Jan. 31, 2013).
[35] http://www.instanttaxservice.com/refund-anticipation-loan-RAL.php (viewed Jan. 31, 2013).

- There are a number of tax preparers near Native American reservations that offer non-bank RALs. Mystery shopper testing in New Mexico by First Nations Development Institute found several examples of these, including an H&R Block franchisee partnering with a non-bank RAL lender.[36] Litigation has been filed against another lender for violations of the Truth in Lending Act.[37]

These non-bank RALs may be more expensive or riskier for consumers than bank RALs. However, they will most likely not be as widespread as bank RALs, at least for now. They will be made on the scale of hundreds of thousands of loans at most, not millions of loans.

First, 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 non-bank lenders are 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.[38] This limits the amount of uniformity that a national tax chain can have when making RALs.

Second, nonbank lenders may also lack the funding necessary to make RALs on a broad scale. Note that in order to make a million RALs, a lender would need $1.5 ***billion*** in capital (assuming loans of $1,500). Furthermore, these funds are necessary for a short period of time – a four to six week period – unlike payday loans, which are spread out over the year and for which roll-overs mean that less real funds are actually extended. It is much easier for a large bank like HSBC and JPMorgan Chase to have such capital. Even smaller banks have had trouble with the amount of funds needed to make RALs; in December 2009, the Office of Comptroller of Currency ordered Santa Barbara Bank & Trust (which then was Jackson Hewitt's RAL lender) out of the RAL market because of the strain that RALs put on the bank's capital levels.[39]

Indeed, the lack of capital for non-bank RALs is related to a problem observed last year with "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 (USDOJ) lawsuit against one such preparer – Instant Tax Service – alleged that the chain promoted RALs made by its affiliate Tax Tree to entice customers, but was so severely undercapitalized that its overall denial rate was often over 90%. According to the USDOJ's complaint:

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[36] Benjamin Marks, Sara Dewees and Shawn Spruce, First Nations Development Institute, More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns, 2012, at 26.
[37] Complaint, Manuelito v. The Big "E," Inc., Civ. No.1:12-cv-01144 (D.N.M. 2012).
[38] For a complete listing of state payday lending laws, *see* www.paydayloaninfo.org/state-information.
[39] NCLC/CFA 2010 RAL Report at 14.

> Defendants know that they have historically needed $200 million in financing to have a RAL approval rate of a mere 50%. ITS Financial admits in internal documents that a 50% approval rate is "bad." Yet for 2012 Tax Tree secured only $15 million to finance all of the loans marketed to Instant Tax Service customers throughout the United States. The prior year it secured even less .... Because Tax Tree is and has been so severely undercapitalized, at times its overall loan denial rate exceeds 90%. In January 2011, for instance, Tax Tree's RAL denial rate was 95%.[40]

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. For example, the Illinois Attorney General's lawsuit against Mo' Money Taxes allege that the chain used offers of RALs to lure customers into providing personal financial information and unwittingly signing a consent allowing Mo' Money to file their tax returns.[41]

D. RAL Volume Plummets in 2011

RAL volume was already decreasing dramatically prior to the exit of the last bank from the market. The latest available IRS data indicates that RAL volume dropped by about 85% from 2010 to 2011. This follows a 30% drop from 2009 to 2010. Only 0.6% of taxpayers obtained a RAL in 2011.[42]

Based on IRS data, we estimate there were approximately 750,000 RALs made in 2011. IRS data shows that there were 1 million RAL applications in 2011.[43] However, not all RAL applications result in loans, as a certain percentage of applications are rejected.

Historically we have used approval rates of 90% and 85% to estimate the number of RALs made in relationship to the number of applications.[44] However, we have used a 75% approval rate for 2010.[45] Thus, we assume a similar approval rate in 2011.

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[40] Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012)., ¶¶ 49-50.

[41] Complaint, People v. Mo' Money Tax Service, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012).

[42] There were 130 million returns filed in the 2011 filing season, which was for Tax Year 2010. Data from IRS SPEC, Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013).

[43] *Id.*

[44] *See* NCLC/CFA 2011 RAL Report 7-8.

[45] *See* NCLC/CFA 2012 RAL Report 6.

Table 1 shows the trends in RALs since 2000, using a 25% rejection rate for 2010 and 2011, a 15% rejection rate for 2007 to 2009 and 10% for years earlier.[46] To give a better indication of RAL trends, it also includes RAL applications in addition to total RALs made. Note that even a rejected RAL costs the taxpayer a fee, because the taxpayer is automatically given a refund anticipation check (RAC) at a cost of about $30 to $35.

TABLE 1

Filing Year	No. of RAL applications	Increase/decrease from prior year	No. of RALs made	RAL loan fees
2011	1 million	(-84.5%)	750,000	$46 million
2010	6.85 million	(-18.5%)	5 million	$338 million
2009	8.4 million	(-14%)	7.2 million	$606 million
2008	9.9 million	(-3%)	8.4 million	$738 million
2007	10.2 million	2%	8.67 million	$833 million
2006	10 million	(-7%)	9 million	$900 million
2005	10.7 million	(-22%)	9.6 million	$960 million
2004	13.8 million	2%	12.38 million	$1.24 billion
2003	13.5 million	(-4%)	12.15 million	$1.1 billion
2002	14.1 million	5%	12.7 million	$1.1 billion
2001	13.4 million	12%	12.1 million	$907 million
2000	12 million	--	10.8 million	$810 million

Most of the dramatic drop in RAL volume was caused by the departure of HSBC (H&R Block's RAL lending partner) and JPMorgan Chase from the RAL market in 2011.[47] That only left three small state-chartered banks remaining in the RAL market in 2011 - Republic Bank & Trust, River City Bank, and Ohio Valley Bank.

The largest of these three banks, Republic Bank & Trust (lender for Jackson Hewitt and Liberty Tax), charged $61.22 for a RAL of $1,500. Thus, we estimate that consumers paid $46 million RALs in 2011. We also estimate that they paid $12 million in add-on fees.

[46] This chart is based on data from IRS SPEC and the annual RAL reports issued by NCLC and CFA.
[47] NCLC/CFA 2011 RAL Report at 5-7.

E. Add-on Fees

Add-on fees are fees separately charged by tax preparers. They are in addition to the RAL or RAC fees charged by the banks. Add-on fees for RALs and RACs appear to be a large source of profits for some preparers.

Of the three major tax preparation chains, only H&R Block does not charge add on fees.[48] Jackson Hewitt and Liberty Tax had promised to stop charging add-on fees several years ago,[49] but then began charging them again in 2010. Jackson Hewitt charges an add-on fee anywhere from $5 to $30.[50] Liberty charged a $20 add-on fee in 2012, which it reduced to $9 in 2013.[51]

In addition, tax preparers not affiliated with one of the three big commercial tax preparation chains will often charge add-on fees. There are multiple types of add-on fees. Some of the names for add-on fees that we have observed include:

- Application fees;
- Data and document storage fees;
- Document processing fees;
- E-filing fees;
- Service bureau fees;
- Transmission/software fees;
- Technology fees.

Some in the tax preparation industry have admitted that add-on fees represent nothing more than an opportunity for profiteering. According to a complaint filed by USDOJ, the owner of Instant Tax Services, Fesum Ogbazion, has called them "junk fees" and "revenue generators."[52] A new provider of RACs called Refundo has also characterized add-on fees as "junk fees."[53]

Some preparers will charge several add-on fees. The cumulative impact of add-on fees can be very expensive. Mystery shopper testing by consumer groups found add-

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[48] Chi Chi Wu and Jean Ann Fox, *Coming Down: Fewer Refund Anticipation Loans, Lower Prices from Some Providers, But Quickie Tax Refund Loans Still Burden the Working Poor*, National Consumer Law Center and Consumer Federation of America, Mar. 2008, at 7.

[49] *Id.*

[50] Visit to Jackson Hewitt office, Prescott Valley, AZ; 2011 RAL Mystery Shopper Report, Appendix A; 2010 RAL Mystery Shopper Report, Appendix B. *See also* JTH Holdings, Inc., Investor Day 2012 Presentation, at 74.

[51] *Id.* at 74-75.

[52] Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012)., ¶ 5.

[53] https://www.refundo.com/?taxrefund (viewed Feb. 10, 2012).

on fee totals ranging from $25 to $324 in 2008;[54] $19 to $85 in 2010;[55] and $35 in 2011.[56] Similar mystery shopper testing by First Nations Development Institute found significant add-on fees.[57]

Some of these add-on fees are not actually determined by the tax preparer, but by the software or transmitter company that the preparer uses. For example, the website for Refundo documents the various "bank technology" and "transmission fees" charged by major software providers, such as Drake, ATX, Intuit ProSeries, and TaxWise, using various RAC providers such as Republic Bank & Trust and Santa Barbara Tax Products Group.[58] When charged, these fees range from $9 to $46.

In some cases, the provider of the financial product builds in the capability to charge add-on fees, as well as capping them. For example, EPS e-Collect (discussed in Section I.B) permits preparers to deduct a transmitter fee; a Service Bureau fee (capped at $35); and up to $999.99 in preparation fees (although EPS will "monitor" fees over $400).[59]

We estimate that 7.6 million consumers paid about $152 million in add-on fees in 2011. We assume that Jackson Hewitt, Liberty and about half of independent preparers charged add-on fees (which is conservative). For RACs, that is 7 million consumers.[60] For RALs, that is about 600,000 consumers.[61] We use an average add-on fee of $20—a conservative assumption given the proliferation of multiple fees.

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[54] 2008 RAL Mystery Shopper Report, Attachment 2.
[55] 2010 RAL Mystery Shopper Report, Appendix B.
[56] 2011 RAL Mystery Shopper Report, Appendix B.
[57] Sara Dewees, First Nations Development Institute, Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses, Apr. 15, 2011, at 14.
[58] https://www.refundo.com/?taxrefund (viewed Feb. 10, 2012). *See also* NCLC/CFA 2010 Report at 18.
[59] EPS Financial, ERO e-Collect Program Handbook 2012, on file with authors.
[60] There were 18.3 million RACs in 2011. See Section 1.B above. Liberty had 790,000 RAC customers in 2011. *See* 2012 NCLC/CFA 2012 RAL Report at 22-23. Jackson Hewitt had about 1.2 million in 2010, so we assume about 1 million in 2011. *Id.* at 21. Block made 6 million RACs. *Id.* at 19. Thus, independents made about 10.5 million RACs.
[61] There were 750,000 RAL consumers in 2011. *See* Section I.D, above. About 60% were Liberty or Jackson Hewitt customers. *See* Section II.D, below. Of the remaining 40%, we assume that half (or 20%) charged add-on fees. That gives us 600,000.

F. Impact on Low-Income Taxpayers and EITC Recipients

RALs and RACs are mostly marketed to low-income taxpayers, and they have the greatest impact on this population. According to IRS data, 94% of taxpayers who applied for a RAL and 84% who obtained a RAC in 2011 were low-income.[62]

The most likely RAL and RAC users are recipients of the Earned Income Tax Credit (EITC). IRS data shows that in 2011 over 85% of RAL consumers and 50% of RAC consumers were EITC recipients.[63] Yet EITC recipients made up only 20% of individual taxpayers in 2011.[64] Thus, EITC recipients are vastly over-represented among the ranks of RAL and RAC consumers.

In addition, IRS data shows that 38% of EITC recipients applied for either a RAL or a RAC in 2011.[65] In other words, a sizable portion of EITC recipients paid part of their publicly funded benefits to a bank to obtain a tax-related financial product. In contrast, only about 9% of taxpayers who do not receive the EITC get a RAL or RAC.[66]

Based on this IRS data, we estimate that about $39 million paid by 638,000 recipients was drained out of the EITC program in 2011 by RAL loan fees.[67] Add-on fees contributed another $10 million to the drain.[68] RAC fees drained about $273 million in fees from the EITC benefit of 9.1 million recipients, plus $70 million in add-on fees.

Non-financial product fees also significantly drain 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 the drain created by both tax-time financial products and by preparation fees. Including tax preparation fees provides a fuller picture of how EITC benefits are

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[62] Data from IRS SPEC, Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013).

[63] IRS reports that 850,000 EITC returns were associated with a RAL application in 2011. Data from IRS SPEC, Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013). Using the 75% approval rate, *see* Section I.C above, the number of approved RALs is 637,500.

[64] There were 26 million EITC returns and 130 million individual tax returns in 2011. Data from IRS SPEC, Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013).

[65] *Id*.

[66] *Id*.

[67] This is 85% of the $46 million total paid for RALs in 2011. *See* Section I.D, above.

[68] This is 85% of the $12 million in add-on fees paid for RALs in 2011. *See id*.

chipped away. The average tax preparation fee in 2011 was $183 at H&R Block[69] and could be higher for other preparers.[70]

Thus, EITC recipients who got RACs and RALs paid an estimated $1.8 billion in tax preparation fees. Including tax preparation fees, RACs and RALs drained $2.2 billion from EITC recipients who were sold these products in 2011.

G. Prepaid Cards

In order to take advantage of the speed of a direct deposited refund, taxpayers must have a bank account or other type of account to receive the refund. Taxpayers without a bank account should be encouraged to open one, but there are other options as well. Taxpayers without a bank account can have their refund deposited to a prepaid card, including any existing payroll or reloadable prepaid card that the taxpayer already has.

Indeed, some states have begun issuing state tax refunds on prepaid cards to taxpayers who do not use direct deposit. These states include Connecticut,[71] New York,[72] Oklahoma,[73] and Virginia.[74] New York's prepaid card appears to be optional, while Connecticut, Oklahoma and Virginia appear to mandate issuance of a prepaid card (with some exceptions) if the taxpayer does not select direct deposit.

There are also a number of prepaid card options offered by private companies specifically targeted for delivery of tax refunds. A few of these cards permit taxpayers to have the costs of tax preparation deducted from their refunds. There are similar prepaid debit cards available to taxpayers who use free Volunteer Income Tax Assistance (VITA) sites.

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[69] H&R Block Inc., 2011 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 19.

[70] Tax preparation fees were as high as $540 in mystery shopping conducted in New York and North Carolina. 2011 RAL Mystery Shopper Report, Appendix A.

[71] Mara Lee, *State Moving Toward Debit Cards for Income Tax Refunds*, Hartford Courant, Feb. 1, 2012, *available at* www.courant.com/business/hc-state-tax-debit-card-20120131,0,6362810.story (last viewed Feb. 21, 2012).

[72] Press Release, *New York State Tax Department Introduces Prepaid Card Option for Personal Income Tax Returns*, Dec. 2, 2011, *available at* www.tax.ny.gov/press/rel/2011/prepaidcard120211.htm (last viewed Feb. 21, 2012).

[73] Ed Doney, *Why You May Not Get All of Your Tax Refund*, KFOR, Jan. 24, 2012, *available at* http://www.kfor.com/news/local/kfor-why-you-may-not-get-all-of-your-tax-refund-20120124,0,5696917.story (last viewed Feb. 21, 2012).

[74] Virginia Dep't of Taxation, Virginia Tax Refund Debit Card, at http://www.tax.virginia.gov/site.cfm?alias=refunddebitcards (viewed Jan. 11, 2013).

Regulations issued by Treasury's Financial Management Service govern the deposit of federal payments, including tax refunds, to prepaid cards.[75] These regulations require that the deposit be subject to FDIC insurance, require compliance with the Regulation E protections for payroll cards, and prohibit deposit to a card that has an attached line of credit or loan feature for which payment is automatically triggered when the federal payment is delivered.[76]

When they are given a choice, taxpayers should be cautious about use of a prepaid card to receive a refund. As with any financial product, taxpayers should compare costs and consumer protections when choosing among options. Some types of prepaid cards have lower fees and better protections than others.

H. Abuses in Tax Preparation Fees

Another problem faced by taxpayers is the lack of transparency around tax preparation fees. Tax preparation is one of the few consumer services in the United States for which consumers cannot obtain a price for the services before they incur them. Tax preparers assert that they charge by the form, and cannot predict which forms will be generated until they actually finish the tax preparation. Thus, consumers cannot comparison shop, or predict how much tax preparation will cost them.

Mystery shopper testing by consumer groups, advocacy groups, the Government Accountability Office, and others has found systemic problems in this area.[77] There are numerous examples of preparers giving low-ball estimates on preparation fees or even refusing to provide testers with a quote.[78]

The U.S. Department of Justice's lawsuit against Instant Tax Service is the latest example of these types of abuses. The USDOJ alleged that:

> Collectively, Instant Tax Service's tax preparation and junk fees typically average more than \$400–\$500, and sometimes run as high as \$1,000 for as little as 15

[75] 31 C.F.R. § 210.5(b)(5).
[76] *Id*.
[77] *See* 2011 RAL Mystery Shopper Report at 5-6; 2010 RAL Mystery Shopper Report at 9-10; 2008 RAL Mystery Shopper Report at 8-9. *See also* Benjamin Marks, Sara Dewees and Shawn Spruce, First Nations Development Institute, More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns, 2012, at 22-23; Sara Dewees, First Nations Development Institute, Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses, Apr. 15, 2011, at 13-15; U.S. Government Accountability Office, Paid Tax Preparers: In a Limited Study, Chain Preparers Made Serious Errors, GAO-06-563T, April 4, 2006, at 24, *available at* http://www.gao.gov/new.items/d06563t.pdf.
[78] *See* NCLC/CFA 2012 RAL Report at 17.

minutes of tax return preparation. Because Instant Tax Service deliberately targets low-income taxpayers, these unconscionably high fees often pose a significant financial hardship for their customers …. Frequently, franchisees also fail to disclose all fees, or they tell customers that they charge one amount for fees and then later increase the fees without the customer's knowledge or consent.[79]

The Illinois Attorney General' lawsuit against Mo' Money Taxes is another example of abuses in tax preparation fees.

Mo' Money Taxes advertised that the cost of their services would be between $150 and $350….In fact, Mo' Money Taxes charged consumers between $480 and $550 to prepare and file their returns, and charged them additional fees totaling $178 for processing the returns….As a result, consumers were typically charged over $700 in fees for preparing, filing, and processing their tax return.[80]

The ability to deduct tax preparation fees from a RAC – or a RAL – compounds this problem, as it makes taxpayers less sensitive to the price of preparation. Normally, a merchant's refusal to provide price information might discourage a consumer from buying a product. However, since the fee is deducted from the RAC, consumers may not be as sensitive to this lack of pricing information. Furthermore, mystery shopper testing has found that the tax preparation fee is often lumped together with RAL/RAC and add-on fees, so that it is impossible to tell how much consumers paid for each item.[81] Some preparers in mystery shopper testing were even reluctant to provide a breakdown of the fees when asked.[82]

Clearly, there is a need for reforms in the disclosure of tax preparation fees. Tax preparers should be required to provide a clear, simple disclosure of tax preparation fees to consumers before beginning the process of tax preparation. This disclosure should be in a tabular format, similar to the disclosure table used in credit card solicitations.

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[79] Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012)., ¶¶ 33-34.

[80] Complaint, People v. Mo' Money Tax Service, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012), ¶¶ 79-81.

[81] *See* 2011 RAL Mystery Shopper Report at 5-6; 2010 RAL Mystery Shopper Report at 9 *See also* Sara Dewees, First Nations Development Institute, Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses, Apr. 15, 2011, at 14, 24.

[82] *See* 2011 RAL Mystery Shopper Report at 5; 2010 RAL Mystery Shopper Report at 9.

I. The Fight for Preparer Regulation

For the past several years, the IRS has been developing a system to regulate tax return preparers by requiring them to register with the IRS, take a competency examination, and stay current with tax law developments through continuing education. On January 18, 2013, a federal district court issued a surprising decision invalidating the IRS return preparer regulations as having exceeded the statutory authority of IRS.[83]

Advocates for consumers and taxpayers were disappointed, as these groups have long supported IRS regulation of tax preparers to protect the rights and interests of consumers. As NCLC and others have repeatedly noted, prior to the IRS regulations, there was absolutely no regulation of tax preparers in most states[84] – no minimum educational, training, competency, or other standards. More regulation is required of hairdressers in many states.

As a result of the lack of preparer regulation, abuses by tax preparers flourished. Mystery shopper testing by consumer[85] and other advocacy groups[86] found examples incompetency and even fraud by preparers – a disturbing number given the limited number of tests conducted. Lawsuits by the USDPJ against Jackson Hewitt[87] and other preparers[88] also found widespread fraud, as have enforcement actions by state regulators.[89]

Other problems with tax preparers include the lack of transparency and outright abuses regarding tax preparation fees,[90] and of course, the promotion and sale of RALs and RACs over the decades. All of these problems could, and should, be addressed by

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[83] Loving v. Internal Revenue Service, ---F.Supp.2d ---, 2013 WL 204667 (D.D.C. Jan. 18, 2013).
[84] The exceptions are California (Cal. Bus. & Prof. Code §§ 22250 to 22259); Maryland (Md. Code §§. 21-101 to 21-502); and Oregon (Or. Rev. Stat. §§ 673.605 to 673.740).
[85] *See* 2011 RAL Mystery Shopper Report at 3-4; 2010 RAL Mystery Shopper Report at 3-4; 2008 RAL Mystery Shopper Report at 9-11.
[86] Sara Dewees, First Nations Development Institute, Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses, Apr. 15, 2011, at 10.
[87] 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.
[88] *See, e.g.*, Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012), ¶¶ 27-28 (noting that Instant Tax Service issues guidance documents to franchises that "encourages franchisees to lie to the IRS in the event of an audit").
[89] Complaint, People v. Mo' Money Tax Service, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012).
[90] *See* Section I.H above.

preparer regulation. The IRS has indicated its intent to appeal the federal district court's decision to the Court of Appeals for the D.C. Circuit.[91]

If the appeal is unsuccessful, other potential avenues for preparer regulation include:

- Congress could pass a law explicitly granting the IRS authority to regulation tax preparers

- If Congress does not act, states could pass laws, similar to those in Oregon and Maryland, to regulate tax preparers.

[91] Andrew Zajac, IRS to Appeal Ruling Barring Licensing of Tax Preparers, Bloomberg News, Jan. 24, 2013.

II. Industry Players

This section provides basic information on the tax-time financial activity of key industry players, an overview that we provide annually. We discuss certain other topics affecting these players, such as regulatory measures, law enforcement actions, and other events, in other parts of this report.

Historically, the tax-time financial products industry was made up of a handful of RAL lending banks, three commercial preparation chains, and thousands of independent preparers that offered and arranged for RALs. While some of the RAL lending banks have exited the market, such as HSBC and JPMorgan Chase, others have switched to making only RACs. The tax preparation chains all still offer RACs, as well as non-bank RALs or pre-season loans.

A. H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 16.4% of all individual tax returns in 2011, or 21.4 million.[92] In 2011, H&R Block did not have the ability to offer RALs because its bank partner, HSBC, was ordered by the OCC to stop making RALs.[93] The company did process 6 million RACs through its own bank, Block Bank,[94] earning it about $180 million.[95] Despite the lack of RALs, H&R Block did not experience a decrease in customers, and in fact gained 3.6% more customers in its retail stores. Block announced in September 2011 that it would not seek a new RAL lending bank for the 2012 tax season.[96]

Block prepared 22.3 million returns in 2012, accounting for 16% of all individual tax returns in that year.[97] It made 6.2 million RACs in 2012,[98] earning it $132 million.[99] Block had offered free RACs that year until February 4, 2012, if the customer agreed to have the RAC deposited on the company's Emerald Card. This decreased the fees that Block earned for RACs by $49.3 million.[100]

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[92] H&R Block Inc., *2011 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 2. [hereinafter H&R Block 2011 Form 10-K].
[93] *See* NCLC/CFA 2012 RAL Report at 17-18.
[94] H&R Block, Inc., H&R Block's CEO Discusses Q4 2011 Results—Earnings Call Transcript, June 23, 2011, *available at* http://seekingalpha.com/
[95] H&R Block Inc., *2012 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 20. [hereinafter H&R Block 2012 Form 10-K]
[96] *See* NCLC/CFA RAL 2012 Report at 17-18.
[97] H&R Block 2012 Form 10-K at 2.
[98] H&R Block, Overview of Financial Services Presentation, Feb. 13, 2013, on file with authors.
[99] H&R Block 2012 Form 10-K at 20.
[100] *Id.*

H&R Block offers the Emerald Card, a prepaid debit card, to its tax preparation customers. H&R Block had about 2.3 million Emerald Cards users in 2011,[101] and 2.9 million in 2012.[102]

The Emerald Card also allows customers to access the Emerald Advance Line of Credit, which is a pre-season or "pay stub" product that provides loans of up to $1,000. The Emerald Advance carries an annual fee of $45 for the first year with an interest rate of 36%.[103] Thus, for a $500 advance repaid in one month, the total fee would be $60. A one-month, closed-end loan with the same loan amount and fee would have an APR of 158%. For returning customers, the annual fee is lowered to $30 for the next year. If the customer secures the line of credit with a deposit in an Emerald savings account, the interest rate is reduced to either 9% or 18%.[104] H&R Block earned about $94 million in interest from Emerald Advances in 2011.[105] It earned about $60 million in interest from its Emerald Advances in 2012.[106]

Even though Block itself did not offer RALs in 2012, one of the companies that Block owns did offer a tax-time loan in that year. TaxWorks, a division of RedGear, which is owned by Block, promoted a "Tax Season Cash Advance" provided by Schear Lending Group and Atlas Financial Services.[107] It appears that Schear Lending Group is not making Tax Season Cash Advances in 2013.

B. Jackson Hewitt

Jackson Hewitt is the second largest tax preparation chain in the country. It has 6,600 company-owned and franchise offices.[108] Because it lost the ability to make RALs in 2010, as well as other factors, Jackson Hewitt has struggled over the past few years. In May 2011, Hewitt filed for bankruptcy protection from its creditors, from which it emerged a few months later.[109]

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[101] H&R Block, Inc., H&R Block's CEO Discusses Q4 2011 Results—Earnings Call Transcript, June 23, 2011, *available at* http://seekingalpha.com/.

[102] H&R Block, Inc., H&R Block Management Discusses Q4 2012 Results - Earnings Call Transcript, June 26, 2012, *available at* http://seekingalpha.com/.

[103] H&R Block, H&R Block Bank Emerald Advance Terms and Conditions, undated, on file with authors.

[104] *Id.*

[105] H&R Block 2011 Form 10-K at 19.

[106] H&R Block 2012 Form 10-K at 20.

[107] NCLC/CFA 2012 RAL Report at 26.

[108] Jackson Hewitt, About Us, http://www.jacksonhewitt.com/About-Us/About-Us/ (viewed Feb. 4, 2013).

[109] Peg Brickley, *Jackson Hewitt Set to Leave Chapter 11*, Wall St. J., Aug. 8, 2011.

Jackson Hewitt does have a pre-season loan product. It has partnered with BillFloat to offer an open-ended line of credit ranging from $200 to $1,000. BillFloat charges a monthly "maintenance" fee of $6.25 plus an "access" fee of 3% or $10, whichever is greater, each time the consumer access the line.[110] Thus, if the consumer has the line for one month and obtains a $500 extension for credit at once, she will pay $38.75. A comparable closed-end loan would have an APR of 93%. BillFloat is actually a third party-provider for the line of credit, as the credit is extended by BofI (Bank of the Internet) Bank.[111]

Jackson Hewitt claims that BillFloat is not a RAL.[112] Although its website does not offer an explanation, its reasoning may be that BillFloat does not necessarily mandate repayment of the loan using the tax refund, but also permits the loan to be repaid in monthly installments rather than by the tax refund. BillFloat does conduct some sort of credit check,[113] which could exclude many former RAL borrowers. One interesting aspect of BillFloat is that it requests online access to a borrower's bank account including a user name and password for its underwriting process, although this information is not required.[114] The need for a bank account may also deter those former RAL borrowers who do not have bank accounts.

It appears that few Jackson Hewitt customers were actually approved for the line of credit. Comments posted by consumers to the Jackson Hewitt Facebook page,[115] as well as the blog BankTalk,[116] almost universally report of frustrations in not being able to access the product.

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[110] Jackson Hewitt, SmartLine™ Line of Credit Description and Frequently-Asked-Questions, Jan. 11, 2013, at https://jacksonhewitt.custhelp.com/app/answers/detail/a_id/2915/~/smartline%E2%84%A2-line-of-credit-description-and-frequently-asked-questions (viewed Feb. 10, 2013).

[111] Jackson Hewitt, Will Jackson Hewitt Tax Service offer the preseason loan this year?, Dec. 22, 2012, at https://jacksonhewitt.custhelp.com/app/answers/detail/a_id/2890/~/will-jackson-hewitt-tax-service-offer-the-preseason-loan-this-year%3F (viewed Feb. 10, 2013).

[112] Jackson Hewitt, What is a SmartLine™ Line of Credit, Jan. 6, 2013, at https://jacksonhewitt.custhelp.com/app/answers/detail/a_id/2912/related/1 (viewed Feb. 10, 2013).

[113] Jackson Hewitt, SmartLine™ Line of Credit Description and Frequently-Asked-Questions, Jan. 11, 2013, at https://jacksonhewitt.custhelp.com/app/answers/detail/a_id/2915/~/smartline%E2%84%A2-line-of-credit-description-and-frequently-asked-questions (viewed Feb. 10, 2013).

[114] *Id.*

[115] https://www.facebook.com/jacksonhewitt (viewed Jan. 23, 2013).

[116] BankTalk, Jackson Hewitt Teams with BillFloat on Credit Lines, Jan. 11, 2013, at http://banktalk.org/2013/01/11/billfloat-powers-tax-season-line-of-credit-at-jackson-hewitthewitt/ (viewed Jan. 23, 2013).

C. Liberty Tax Service

Liberty Tax is the third significant commercial tax preparation chain in the country, with almost 4,200 locations.[117] Liberty Tax prepared about 2 million returns in both 2011 and 2012.[118] The chain is well-known for hiring people to stand outside stores, dressed up in Statue of Liberty costumes, as a form of advertisement during tax season.

Liberty earned $16.5 million in RAL and RAC fees in 2011, constituting 17% of net revenue.[119] It earned $22.9 million in RAL and RAC fees in 2012 or 21% of its revenue.[120]

In 2011, Liberty sold financial products to 902,000 customers - nearly half of its customer base.[121] However, it sold a RAL to only 5.6% of its customers in 2011, or about 112,000.[122] In 2012, Liberty sold financial products to 922,000 of customers, of which 3.4% (or about 70,000) obtained a bank RAL.[123] In addition, Liberty offered Instant Cash Advances (ICA) loans in 2012, which are non-bank RALs. Liberty reported that it incurred a $1.1 million loan loss on ICAs, which represented 2.4% of the ICA loans in 2012 – about $45.8 million in loan volume.[124] Since Liberty had an average loan of $2,033,[125] it made about 22,500 ICA loans in 2012.

In 2013, Liberty has again partnered with non-bank lenders to make RALs. Its website shows that it has partnered with 1st Money Capital and RedPoint Capital.[126] The CEO for 1st Money Capital is Michael Brent Turner. Mr. Turner's LinkedIn profile notes that he was previously President of eCommerce and Card Services for EZCORP, the big public pawn/payday/title loan company, as well as Vice President of Financial Services at Rent-A-Center.[127] The Director of Licensing for 1st Money Capital is Cathy Rutledge, who used to work for Eugene McKenzie.[128] Mr. McKenzie is the President of

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117 JTH Holding, Inc., *2012 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 6. [hereinafter "Liberty Tax Service 2012 Form 10-K"].
118 *Id.*
119 JTH Holding, Inc., Form S-1: Registration Statement under the Securities Act of 1933 (amended version Nov. 7, 2011), at 8 [hereinafter "Nov. 2011 Liberty Tax Service Prospectus"].
120 JTH Holding, Inc., Amendment No. 5 to Form S-1: Registration Statement under the Securities Act of 1933 (amended version Oct. 15, 2012), at 44 [hereinafter "Oct. 2012 Liberty Tax Service Prospectus"].
121 Nov. 2011 Liberty Tax Service Prospectus at 41.
122 *Id.* at 43.
123 Oct. 2012 Liberty Tax Service Prospectus at 21, 41.
124 JTH Holdings, Inc., Investor Day 2012 Presentation, at 77.
125 *Id.*
126 *See* www.libertytax.com/refund-and-loan-options.html (visited Feb. 6, 2013).
127 http://www.linkedin.com/pub/brent-turner/1/912/6b3?trk=pub-pbmap (viewed Feb. 20, 2013).
128 http://www.linkedin.com/pub/cathy-rutledge/1a/311/676 (viewed Feb. 20, 2013).

SGS Credit Services, which was Liberty's non-bank lender in 2012.[129] He was also the former treasurer for the Texas Consumer Lenders PAC, and both he and the PAC were purportedly top donors among payday lenders to Texas politicians.[130]

As for RedPoint Capital, it combined with Texas Loan Corporation in 2010 to form Infinity Specialty Finance, which is also headed by Eugene McKenzie.[131]

D. Smaller Banks and Tax Preparation Chains

The last remaining bank in the RAL market in 2012 was Republic Bank & Trust, a state-chartered bank located in Louisville, Kentucky. Republic's major tax preparer partners were Jackson Hewitt and Liberty Tax Service, which switched to Republic after Santa Barbara Bank & Trust was forced to exit the RAL market.[132] In 2011, Hewitt represented 40% of Republic's RAL and RAC business, while Liberty Tax represented 20%.[133]

Republic's CEO reported that it made 3.5 million RALs and RACs in 2011.[134] Since Republic earned $88 million in RAC fees in 2011,[135] at the cost of $30 per RAC, it made about 2.9 million RACs and thus about 600,000 RALs. In 2012, Republic reported that it had $10.4 million in RAL volume outstanding, which represented 1.35% of its RALs in 2012 – about $770 million in loan volume.[136] Since Republic made RALs of $1,500, it made about 500,000 RALs in 2012.

Santa Barbara Tax Products Group (SBTPG) is the former Pacific Capital Bancorp RAL unit that was spun off after that bank was ordered to cease making RALs by its federal

[129] NCLC/CFA 2012 RAL Report at 22.
[130] Texans for Public Justice, Loan-Shark-Financed Campaigns Threaten Payday-Loan Reform, March 2011, *available at* http://info.tpj.org/reports/pdf/PaydayReport.mar2011.pdf.
[131] Press Release, Texas Loan Corporation and Redpoint Capital Combine Strengths to Form INFINITY SPECIALTY FINANCE, June 22, 2010, *available at* http://www.prnewswire.com/news-releases/texas-loan-corporation-and-redpoint-capital-combine-strengths-to-form-infinity-specialty-finance-96882614.html
[132] *See* NCLC/CFA 2010 RAL Report at 15.
[133] Republic 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 September 30, 2011, at 55 [hereinafter Republic
September 2011 Form 10-Q].
[134] Bloomberg News, Pre-Refund Loans Fading into Past, Portland Press Herald, Dec 20. 2011.
[135] Republic September 2011 Form 10-Q at 4.
[136] Republic 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 September 30, 2012 at 47 [hereinafter Republic September 2012 Form 10-Q].

regulator, the Office of the Comptroller of Currency.[137] SBTPG's offerings for 2013 include a RAC product that it calls a "Refund Transfer," as well as a state Refund Transfer program. It partners with University Bank in Minneapolis, MN, to make RACs.

River City Bank in Louisville, Kentucky, was formerly a RAL lending bank but decided to exit the business last year when the FDIC notified the bank that making RALs without the Debt Indicator was "unsafe and unsound."[138] River City still provides a RAC product.

The tax preparation industry contains a number of smaller chains. Two of the most notorious are Mo' Money Taxes and Instant Tax Service. Both have been the subject of law enforcement actions in 2012, discussed in Section III.B.

E. Tax-Time Products at Fringe Financial Outlets

Storefront financial services outlets -- including check cashers; payday lenders; rent-to-own stores; retailers; car dealers; and other fee-based providers -- have long participated in the frenzy to make money during tax season, when low- to moderate-income consumers receive the largest single infusion of funds at any point in the year. With the demise of RAL products, the ability to sell "fast" money is changing.

A few fringe outlets, discussed in Section I.C, offer non-bank RALs. Some fringe outlets offer tax preparation services without selling RALs or other loans labeled as tax-time credit. For example, Cash America, the large pawn/payday loan national chain, promotes its tax filing services on its website. However, the fine print on the website discloses that Cash America "does not provide tax preparation advice, nor prepare or file tax returns. Cash America is a sales representative of E-Tax."[139] E-tax is a remote tax preparation program that promotes itself as a "direct to business" tax preparer.[140]

PLS Loan Stores, a chain that offers check cashing; payday lending; and auto title loans, also offers in-store tax return preparation for federal and state returns. To get refunds faster, PLS urges filing as soon as possible and use of direct deposit to the taxpayer's bank account or a RAC as speedier options.[141]

National Cash Advance, a payday lender, offers to estimate taxes with actual tax preparation provided by eTax. National Cash Advance's website also offers a coupon

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[137] *See* NCLC/CFA 2010 RAL Report at 14-15.
[138] *See* NCLC/CFA 2011 RAL Report at 6.
[139] www.cashamerica.com/FinancialServices/TaxFilingServices.aspx (visited Feb. 18, 2013).
[140] *See* NCLC/CFA 2012 RAL Report at 29.
[141] www.plshome.com/tax-preparation/ (visited Feb. 18, 2013).

for $20 off the consumer's tax preparation fee.[142] This same offer is made by National Cash Advance's parent, Advance America, the large national chain of payday lenders.[143]

Some fringe outlets are only promoting tax check cashing services. ACE Cash Express is not promoting tax preparation but is offering $10 off its check cashing fee for refunds.[144] ACE is also promoting loading federal tax refunds onto an ACE Elite Visa prepaid card, issued by NetSpend. Consumers who do so get a chance to win groceries for a year, valued at $12,000.

CheckSmart outlets in Arizona again offered title loans as tax-time loans during January, for a special rate of $99.[145] These loans were actually made by Buckeye Title Loan. Tax returns are prepared by eTax Partners.[146] CheckSmart is also again issuing the Insight Card[147] issued by Urban Trust Bank.[148] The Insight Card has been the subject of some controversy, with the Office of the Comptroller of the Currency (OCC) finding "violations of law and regulations and unsafe and unsound banking practices" after NCLC, CFA and Center for Responsible Lending sent the OCC a letter detailing the use of the Insight Card by CheckSmart to make payday loans in violation of state laws.[149]

Last but not least, the NCLC/CFA annual reports have discussed TRS Refund Services several times. This company is still advertising its TaxMax program for auto dealers, promoting tax preparation and refunds as a way to bolster purchases for autos. The website offers offers two products, a Fourth Quarter Sales Program and a First Quarter Sales Program.[150] The Fourth Quarter Sales Program allows car dealers to estimate a taxpayer's refund for the next tax year and allows the dealer to treat future tax refund proceeds as a down payment for a car purchase in October, November and December.[151] The online portal estimates the consumer's refund using the last paystub

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142 www.nationalcashadvance.com/ourservices_tax.php (visited Feb. 18, 2013).
143 http://www.advanceamerica.net/services/details/tax-services (visited Feb. 18, 2013).
144 https://www.acecashexpress.com/store-services/tax-checks.
145 http://www.checksmartstores.com/arizona/title-loans/ (visited January 21, 2013).
146 http://www.checksmartstores.com/arizona/other-services/ (visited January 21, 2013).
147 http://www.checksmartstores.com/arizona/prepaid-cards/ (visited January 21, 2013)
148 Urban Trust Bank has had a history of offering high-cost credit products, such as a fee-harvester credit card called the "My Salute Card." *See* Rick Jurgens & Chi Chi Wu, National Consumer Law Center, Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers 3 (Nov. 2007), at 19-20, *available at* www.consumerlaw.org/issues/credit_cards/content/FEE-HarvesterFinal.pdf.
149 Press Release, National Consumer Law Center, Banking Regulator Slams Urban Trust Bank, Issuer of Prepaid Card Payday Loans, Sept. 24, 2012, available at http://www.nclc.org/images/pdf/pr-reports/pr-occ-check-smart.pdf.
150 https://www.taxmax.com/TRSTaxMax/HowItWorks.aspx (visited Feb. 7, 2013).
151 https://www.taxmax.com/TRSTaxMax/FourthQuarterSalesProgram.aspx (visited Feb. 7, 2013).

and, then generates the appropriate supporting documents, including a promissory note for the customer to sign.[152]

The First Quarter Tax Max Marketing Program is a tax preparation and loan program designed to allow car dealers to prepare tax returns onsite and use the proceeds to help fund the down payment for a car purchase at the point of sale.[153] TRS Tax Max provides car dealers with an online portal to prepare a taxpayer's return and determine the amount of the refund. Funds are dispersed directly to the dealer in 7 to 20 days.[154] TRS Tax Max charges start at $139, the fees are deducted directly from the taxpayer's refund, and the bank partner fee is $59.[155]

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[152] https://www.taxmax.com/TRSTaxMax/HowItWorks.aspx (visited Feb. 7, 2013).
[153] *Id.*
[154] https://www.taxmax.com/TRSTaxMax/FAQ.aspx (visited Feb. 7, 2013).
[155] https://www.taxmax.com/TRSTaxMax/HowItWorks.aspx (visited Feb. 7, 2013).

III. Regulation, Enforcement, Litigation And Advocacy

A. RAL Legislation

Illinois[156]

Illinois amended its RAL law to add substantive protections for consumers. The new provisions prohibit a facilitator of RALs or RACs from charging the consumer a fee or other consideration apart from the fee charged by the creditor. Thus, Illinois bans add-on fees, such as document preparation, service bureau, or transmitter fees. The Illinois law does permit facilitators to charge a tax preparation fee if the same fee in the same amount is charged to all customers, including those who do not obtain RALs or RACs.

The new provisions of the Illinois law contain a rate cap for non-bank RALs of 36% APR. There are additional prohibitions against: (1) directly or indirectly arranging for any third party to charge a fee for check cashing, insurance, attorney's fees, or collection costs; (2) engaging in collection of a delinquent RAL debt by offset of a tax refund; (3) arranging for RALs secured by state tax refunds; and (4) including certain abusive clauses in a RAL contract.

As for disclosures, the Illinois law requires facilitators to post a schedule of RAL fees and interest rates in a 16 by 20 inch document in 28-point type, as well as provide a written document with disclosures. The wall posting must include a warning that: (1) a RAL is a loan; (2) the consumer is liable for the full amount of the loan if the tax refund is less than expected; and (3) the consumer can receive a refund in eight to fifteen days without paying any extra fees or taking out a loan. Both the wall posting and written disclosures must use a special RAL interest rate that includes the fee for the temporary or "dummy" bank account in its calculation.

There are currently a total of 20 states regulating RALs: Arkansas, California, Colorado, Connecticut, Illinois, Louisiana, Maine, Maryland, Michigan, Minnesota, Nevada, New Jersey, New York, North Carolina, Oregon, Tennessee, Texas, Virginia, Washington State, and Wisconsin. The laws for 13 of these states are summarized in Appendix A to NCLC's model state RAL law.[157]

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[156] 815 Ill. Comp. Stat. §§ 177/1 to 177/40.

[157] Available at http://www.nclc.org/images/pdf/high_cost_small_loans/ral/model-refund-anticipation-loan-act.pdf.

Most of these laws rely on disclosures to protect consumers from RAL abuses, which are limited in their effectiveness. However, RAL laws in Arkansas, Connecticut, Illinois, Maine, Maryland, Minnesota, and New York provide substantive protection by prohibiting add-on fees. The Illinois law caps non-bank RALs at 36%. The Connecticut law prohibits RAL facilitators from facilitating a RAL costing over 60% APR; however, the federal Court of Appeals for the Second Circuit struck down this provision as applied to national banks, holding that it was preempted by federal banking law.[158] The Connecticut law should be effective as to non-bank RALs.

B. Regulation and Enforcement

The most notable enforcement actions in 2012 were the U.S. Department of Justice's (USDOJ) lawsuit against Instant Tax Service and the Illinois Attorney General's lawsuit against Mo' Money Taxes.

United States v. Instant Tax Service[159]

The USDOJ filed a lawsuit against Instant Tax Service in March 2012, alleging that Instant Tax franchisees intentionally prepared fraudulent tax returns to maximize their customers' refunds in order to extract large tax preparation fees from these refunds. The lawsuit alleged that the tax preparation fees, combined with RAC and add-on fees, were outrageously high – up to $1,000 for as little as 15 minutes worth of work– and were often not disclosed to customers. The complaint states that the estimated tax losses from the allegedly fraudulent returns prepared in 2011 at Instant Tax locations in St. Louis, Kansas City, Chicago, Indianapolis and Las Vegas exceeded $16 million.

Illinois v. Mo' Money Taxes[160]

The Attorney General's office sued Mo' Money Taxes for filing tax returns without consumers' authorization, filing erroneous tax returns, and charging undisclosed and exorbitant fees for tax preparation. The complaint alleged that Mo' Money used offers of RALs to lure consumers into providing their personal information, and signing a form that – unbeknownst to the consumer – gave Mo' Money the right to file tax returns on their behalf. Mo' Money would then file the consumers' tax returns and automatically deduct hundreds of dollars in undisclosed fees from their refunds – as much as $700 per person. Many of these

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[158] Pacific Capital Bank, N.A., v. Conn., 542 F.3d 341 (2d Cir. 2008).

[159] Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012)., ¶¶ 49-50.

[160] Complaint, People v. Mo' Money Tax Service, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012).

returns also contained incorrect information. Some consumers did not receive any refunds, or received refund checks that were not honored by banks.

C. Litigation

People v. JTH Tax, Inc.[161]

On January 17, 2013, a California appellate court issued a decision in this case with far-reaching implications. The appellate court affirmed the judgment obtained by the California Attorney General against JTH, Inc. (better known as Liberty Tax). Most importantly, the appellate court upheld the trial court's ruling that a RAC actually constitutes a loan for Liberty's tax preparation fee, and thus RAC fees are finance charges under the Truth in Lending Act. Furthermore, the failure to disclose the RAC fee as a finance charge violated California's Unfair Competition Law (UCL) and False Advertising Law (FAL).

Liberty had argued that the RAC fee was not a finance charge because it was charged in comparable cash transactions. The Court rejected this argument, citing in particular the fact that only four out of the 60,000 California customers who purchased a RAC between 2002 and 2007 paid up front for tax services.

The appellate court also upheld the trial court's ruling that cross-lender debt collection (*i.e.* using RALs and RACs to collect on old, defaulted RAL debt) violated California law. However, the affirmance was on technical grounds, as the appellate court held that Liberty failed to challenge in its opening brief the trial court's ruling that Liberty's practices violated California's UCL and FAL, and thus waived this argument on appeal. The appellate court did not address the issue of whether Liberty's cross-lender debt collection practices violated the federal Fair Debt Collection Practices Act (FDCPA) and the California version of the FDCPA.

Finally, the appellate court ruled that Liberty could be held vicariously liable for its franchisees' advertising. It upheld the award of $1.169 million in civil penalties and $135,000 in restitution.

Smith v. Intuit, Inc.[162]

A number of class action lawsuits in different states were brought against H&R Block and Liberty Tax Service over their RAL and RAC programs.[163] One of the

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[161] --- Cal.Rptr.3d ---, 2013 WL 177140 (Cal. Ct. App. – 1st Dist. Jan. 17, 2013).
[162] 2012 WL 3945485 (N.D. Cal. 2012).
[163] *See* NCLC/CFA RAL 2012 Report at 34.

primary allegations in these lawsuits is that the RACs offered by these companies are in fact disguised loans of the tax preparation fees. In Smith v. Inuit, Inc., a federal district court rejected this theory, holding that a RAC is not a "loan" under the California RAL law or usury statute. This decision is in stark contrast to the California state appellate court's decision in People v. JTH Tax, Inc., discussed directly above, which appears to be the more thoroughly reasoned of the two.

Conclusion

The tax-time financial products market is evolving after the departure of bank RALs. Tens of millions of taxpayers continue to be sold RACs, which can be subject to significant add-on fees and may represent a high-cost loan of the tax preparation fee. A number of payday lenders and other non-bank businesses are making non-bank RALs, which may be more expensive but are also far less prevalent. Another problem is "phantom" RAL lending, where less-than-scrupulous tax preparers claim to have RALs but do not, in order to lure consumers into their offices.

The tax preparation fee itself is a source of potential consumer confusion, with high fees and the inability for consumers to obtain estimates to comparison shop. Tax preparation fees should be subject to a standardized, easy-to-understand disclosure. There are many challenges remaining to protect low-income taxpayers from profiteering and abuse.

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