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CFA Consumer Federation of America

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A MINEFIELD OF RISKS FOR TAXPAYERS

New Report on the Perils Taxpayers Face from Unregulated Preparers, Lack of Fee Disclosure, and Tax-Time Financial Products

Download the full report: http://bit.ly/1Rqr1Z1

(BOSTON) As tax season nears the finish line, advocates from the National Consumer Law Center and Consumer Federation of America issued their annual report on tax-time consumer issues: *Minefield of Risks: Taxpayers Face Perils from Unregulated Preparers, Lack of Fee Disclosure, and Tax-Time Financial Products.*

The report discusses the risks and problems faced by taxpayers who use paid tax preparers, including:

- **Fraud and errors from unregulated preparers**. The vast majority of paid tax preparers are not required to meet any minimum educational, competency, or training standards. Consumers are at risk from preparers who make errors or even commit fraud, exposing them to the possibility of audits by the Internal Revenue Service (IRS) or even criminal sanctions.

- **Lack of price transparency and inability to comparison shop**. Tax preparation is one of the few services that do not provide meaningful price information to consumers. Fees can be as high as $400 to $500, but preparers often refuse to provide firm price quotes ahead of time.

- **Needless fees paid for financial products.** Paid preparers offer and promote financial products that can be unnecessary and expensive, such as refund anticipation checks (RACs).

"There's a minefield of dangers for the tens of millions of consumers who use paid tax preparers to fill out their most important financial document of the year," said Chi Chi Wu, staff attorney at the National Consumer Law Center (NCLC). "The hazards range from losing a chunk of their refund for unnecessary financial products, to errors or even fraud committed by unregulated preparers."

Consumer advocates are also seeing a new generation of refund anticipation loans (RALs) on the market. These RALs are different from the ones that were driven from the market several years ago in that they claim not to charge a fee for the loan. However, some of these products could pose other perils, such as the possibility that paid preparers will increase their tax prep fee to include the cost of the RAL.

Taxpayers at Risk from Incompetent and Abusive Paid Preparers

In all but four states (CA, MD, NY and OR), paid tax preparers are not required to meet any minimum educational, competency, or training standards. While some tax preparers are licensed as attorneys or certified public accountants (CPAs) or credentialed by the IRS as enrolled agents, these certifications are not mandatory and most preparers do not have them. Indeed, the only tax preparers, apart from attorneys, CPAs and enrolled agents, who are required to pass a test are the unpaid volunteers at Volunteer Income Tax Assistance (VITA) and AARP Tax-Aide sites.

A recent national poll commissioned by the Consumer Federation of America reveals broad public support for government oversight of tax preparers. The poll found that more than 4 out of 5 respondents believe that paid tax preparers should be required to pass a competency test, be licensed by the state, and provide a clear, upfront list of fees before completing a taxpayer's return. In particular, the poll found that:

- ***80% of the public supports requiring paid tax preparers to pass a test*** administered by the government that would ensure that paid preparers have the knowledge and training to complete taxpayer returns correctly.
- ***56% of the public believes paid preparers should have special training*** but don't need a degree and 31% of the public believes that paid tax preparers should have a college degree in accounting.
- ***83% of the public supports licensing requirements for paid preparers*** by a state agency that would also accept and resolve complaints, and enforce consumer protections.

The complete results of the poll are available at: http://bit.ly/1PpGALd

"This new national poll shows that taxpayers want the protection and peace of mind that their preparer is competent and held accountable," said Michael Best, senior policy advocate at the Consumer Federation of America. "State legislatures and Congress have the authority to implement common sense protections for taxpayers, who have expressed strong support for such protections."

The lack of competency standards for paid preparers exposes consumers to potential error or even fraud, as well as potentially costing federal and state governments tens of millions of dollars in lost tax revenue. Multiple rounds of mystery shopper tests of tax preparers have found high levels of errors, and even instances of fraud by tax preparers.

In 2015, mystery shopper testing by consumer advocacy groups in Florida and North Carolina found inaccuracies in 27 out of the 29 tax returns prepared by paid tax preparers. One group of testers posed as a single parent who was not entitled to claim her minor child because the child lived with the other parent for more than 50% of the time. Yet 8 of the 15 preparers claimed the child, resulting in an improper Earned Income Tax Credit (EITC) of $2,523. Another set of testers posed as graduate students with a paid internship for which s/he was given a 1099. Ten of the 14 preparers did not properly use a Schedule C to report the internship income, resulting in the omission of nearly $1,300 in self-employment tax. And 3 of the 4 preparers who did properly use a Schedule C took questionable deductions, including one preparer who made up $9,562 in fictitious businesses expenses.

In 2014, the U.S. Government Accountability Office (GAO) sent undercover investigators to 19 randomly selected tax preparer offices. Only two of the 19, or 11 percent, of the returns had the correct refund amount. Other rounds of mystery shopper testing are summarized in a March 2014 report by NCLC, with the percentages of problematic tests in these other testing programs ranging from 25 percent to 90 percent. NCLC has developed a Model Individual Tax Preparer Regulation Act for states to consider in regulating tax preparers.

Tax Preparation Fees Are High and Opaque

Tax preparation fees are often high, and almost always non-transparent, making it nearly impossible for consumers to comparison shop. Tax preparers can charge up to $500 or more in fees, yet many will claim they cannot give a price quote or will give inaccurate estimates.

Mystery shopper testing conducted last year by consumer groups revealed wildly differing fees for each of the two testing scenarios. Fees ranged from $37 to $427 for the single parent scenario, and $50 to $341 for the graduate student scenario. Furthermore, fees were generally higher for the single parent tester when the preparer improperly claimed the daughter. The GAO testing in 2014 similarly found widely varying fees, even between offices affiliated with the same chain: between $160 to $408 for one testing scenario and $300 to $587 in the other.

"The lack of transparency and disclosure in tax preparation fees is appalling," stated National Consumer Law Center staff attorney Chi Chi Wu. "Without adequate price information, it's a complete failure of the competitive market."

The CFA poll, discussed above, found overwhelming public support for requiring paid preparers to disclose their fees: 89% of respondents support requiring paid preparers to supply an upfront list of fees. The NCLC Model Individual Tax Preparer Regulation Act includes a provision that would require paid preparers to provide a standardized disclosure of their fees in the form of a table.

"It is not surprising that the public overwhelmingly supports requiring upfront pricing from paid preparers—households need every penny of their refunds and should be able to comparison shop paid preparers for the best value just like they can for other services," said CFA senior policy advocate Michael Best.

Tax-Time Financial Products Evolve

In the past, millions of taxpayers lost a significant chunk of their refunds to high-cost, high-risk refund anticipation loans (RALs) made by banks. While these bank RALs are no longer being made, other tax-time financial products can drain the refunds of taxpayers or otherwise put them at risk.

- **Refund anticipation checks (RACs)** – RACs are a financial product used to deliver tax refunds and to pay for tax preparation fees by deducting them from the refund. Preparers charge a fee for these RACs of $25 to $60, instead of setting up direct deposit for free.
- **RALs from non-bank lenders** – Payday and other non-bank lenders are offering RALs. These loans could be more expensive and riskier than bank RALs.
- **"No–fee" RALs –** Some lenders are offering RALs that do not impose a charge directly on the consumer, though there is concern that some preparers may pass the cost of the loans onto the taxpayer through an increased tax preparation fee or junk fees.

RACs

With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund monies. After the refund is deposited, the bank issues the consumer a check or prepaid card and closes the temporary account. RACs do not deliver refund monies any faster than the IRS can, yet they cost $25 to $60. Some preparers charge additional "add-on" junk fees for RACs, fees that can range from $25 to several hundred dollars.

RACs are the major tax-time financial product on the market. There were an estimated 21.6 million taxpayers who received a RAC in 2014.

Since the main purpose of a RAC is to defer payment of the tax preparation fee until the refund arrives, it can be viewed as a high-cost loan of that fee. If a taxpayer pays $35 to defer payment of a $350 tax preparation fee for 3 weeks, the annual percentage rate (APR) is 174%.

Non-bank and "No-Fee" RALs

After banks exited the RAL market in 2012, non-bank lenders, such as payday lenders, started to make RALs. These RALs are not nearly as widespread as bank RALs once were. In 2014, only 35,000 consumers applied for a non-bank RAL, according to IRS data. In comparison, about 12.7 million consumers obtained a RAL at the height of the industry in 2002.

Non-bank RALs could be more costly or riskier than the ones made by banks. For example, in 2015, the Consumer Financial Protection Bureau (CFPB) took enforcement action against a non-bank RAL lender, Southwest (S/W) Tax Loans, that targeted Native American taxpayers. The CFPB alleged that the RALs had Annual Percentage Rates (APRs) of over 240%, but that S/W Tax Loans fraudulently disclosed lower APRs. In addition, when customers asked about the status of their refunds, they were deceptively persuaded to take out a second or third RAL even though the IRS had already sent their refunds.

One of the largest non-bank RAL lenders is 1st Money Center. Previously, 1st Money Center offered RALs through Liberty Tax Service and software providers such as Drake Software, for which it charged fees translating into APRs as high as 218%. This year, 1st Money Center is offering "advances" that do not impose a charge on the consumer for the loan. In addition, 1st Money Center states it has exited the payday loan business.

1st Money Center is offering "no-fee" RALs of up to $750 through a number of entities, such as Jackson Hewitt. In addition, 1st Money Center is the official lender for the "Prefund" no-fee RAL offered by Santa Barbara Tax Products Group (SBTPG), which was purchased in 2014 by prepaid card provider Green Dot.

Another lender that is making "no-fee" RALs is Republic Bank & Trust. Republic was the last bank to stop making high-cost RALs in 2012, and it appears that the bank is back in the business of tax refund lending. Republic Bank is one of the "no fee" RAL lenders for Liberty Tax.

Some lenders for "no fee" RALs, such as River City and EPS Financial, appear to actually impose a cost, if the consumer also obtains a RAC. A tax preparer that does not offer the "no-fee" RAL has the option of offering RACs for a lower fee. In the case of River City, a preparer who does not offer "no-fee" RALs could instead charge $34.95 (and receive a $5 "rebate") or $29.95 (no rebate) for a RAC – as opposed to $39.95. In the case of EPS Financial, a preparer must charge $35 if it arranges a "no fee" RAL, but it can offer a RAC with a cost ranging from free to $20 as long as the preparer is willing to forego a rebate.

Even the "no-fee" RALs that do not impose a fee directly on the consumer, such as those offered by SBTPG and Republic Bank, could present risks for consumers. The lenders charge the tax preparers a fee of $35 for these RALs. Preparers might pass along these fees, or charge even more, by padding their tax preparation fees or by charging separate "add-on" junk fees. Since few consumers get a firm price estimate before having their returns prepared, these hidden fees can be hard to avoid. SBTPG has stated that it prohibits preparers from charging higher tax preparation fees to Prefund customers and that it will audit preparers to enforce that rule. In addition, consumers apply for Prefund RALs directly with SBTPG, so the preparer does not know which customers are approved for the loan. However, tax preparers who use RALs offered through other channels might pass along the RAL fee.

Previously, one risk of RALs was that, if the refund is miscalculated or seized by the government to repay a student loan or another debt, the consumer could be liable for repaying the loan. However, SBTPG has stated that its no-fee RAL is a non-recourse loan, i.e., the consumer is not required to repay the loan if the refund is not received. According to the blog BankTalk, Republic Bank's loan is non-recourse as well. However, it is unclear whether other "no-fee" RALs are non-recourse.

Related Materials

NCLC:

NCLC Report: *Prepared in Error* (April 2015) is available at:
http://www.nclc.org/issues/prepared-in-error.html

NCLC Report: *Riddled Returns* (March 2014) is available at:
http://www.nclc.org/issues/riddled-returns.html.

NCLC's Model Individual Tax Preparer Regulation Act (November 2013), is available at:
http://www.nclc.org/images/pdf/high_cost_small_loans/model-individual-tax-preparer-reg-act.pdf.

NCLC has worked for over a decade on the issue of tax-time financial products, particularly refund anticipation loans (RALs). NCLC's annual RAL reports and other materials are available at www.nclc.org/issues/refund-anticipation-loans.html.

CFA:

CFA Report: *Public Views on Paid Tax Preparation: Strong Public Support for New Consumer Protections to Prevent Errors and Fraud* (January 2016) is available at: http://bit.ly/1PpGALd

CFA Report: *Protecting Consumers at Tax Time: Federal and State Efforts to Address Common Problems Associated with Paid Tax Preparation* (January 2015) is available at:
http://bit.ly/1He2Cm5

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The **Consumer Federation of America** is an association of more than 250 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education. **www.consumerfed.org**