FOR IMMEDIATE RELEASE:
JANUARY 29, 2018

Contacts: (NCLC): hi Chi Wu (cwu@nclc.org) or
Jan Kruse (jkruse@nclc.org); (617) 542-8010
(CFA): Michael Best (mbest@consumerfed.org);
(202) 939-1009

Tax Time Consumer Issues: New Risks, Old Problems

NCLC and CFA Annual Advisory Warns that Taxpayers Face Perils from Incompetent Preparers, Refund Delays, and New and Old Tax-Time Financial Products

WASHINGTON **-** It's opening day for filing your tax return, and this year promises to bring a grab bag of consumer protection perils. Advocates from the National Consumer Law Center and Consumer Federation of America issue their annual consumer advisory on these perils, including:

- **Financial products are a mixed bag.** Paid tax preparers offer and promote financial products that vary in cost and usefulness, including "no fee" refund anticipation loans (RALs) and refund anticipation checks (RACs). "No fee" RALs do not directly charge interest or a fee but some of them may have hidden indirect costs. RACs claim they are not a form of credit, but they may actually represent a high-cost loan of the tax preparation fee. About 1.7 million taxpayers applied for a RAL in 2017. Another 20.5 million taxpayers paid over $500 million for RACs in 2017.

- **Refund delays continue for millions of vulnerable taxpayers.** As happened last year, refunds for recipients of the Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) will be delayed until late February. This may cause cash-flow problems for millions of financially strapped taxpayers who, prior to 2017, received their refunds several weeks earlier.

- **Fraud and errors from unregulated preparers.** The 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 commit fraud.

- **Private debt collectors are dunning financially strapped taxpayers**. The IRS has begun placing federal tax debts with private collectors. Over 40% of the taxpayers who paid the IRS after being dunned by private collectors were financially vulnerable consumers. Meanwhile, the IRS private debt collection program cost $20 million to operate in 2017 while only generating
$6.7 million in revenue, for a loss of $13.3 million.

- **Taxpayer ID number renewals required**. Another wave of 1.2 million taxpayers with Individual Taxpayer Identification Numbers (ITINs) will need to get these numbers renewed, also potentially delaying processing of tax refunds.

"Tax-time is hard enough for most Americans, but they also face consumer protection challenges," **noted Chi Chi Wu, staff attorney at the National Consumer Law Center.** "They need to avoid incompetent and abusive preparers and decide whether to choose financial products of varying costs. The fact that Congress has delayed refunds for some of the neediest taxpayers makes the situation all that much worse."

Tax-Time Financial Products

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 high-cost RALs are no longer being made, other tax-time financial products can skim 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 typically charge a fee for these RACs of $30 to $40.
- **"No–fee" RALs –** These RALs generally do not impose a charge directly on the consumer, though there are some pricing structures that end up costing consumers indirectly or for additional loans.

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 typically cost $30 to $40. 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 20.5 million taxpayers who received a RAC in 2017, spending over $500 million for them.

Since the main purpose of a RAC is to defer payment of the tax preparation 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 three weeks, the annual percentage rate (APR) is 174%.

"No-Fee" RALs

With the tax refund delays described in the next section, "no fee" RALs may prove attractive to many consumers. These are loans that are secured by the taxpayer's refund, but the lender does not charge the taxpayer a fee or finance charge. Instead, some lenders charge the preparer a fee. Many lenders and preparers call these products an "advance," but they are actually loans.

An estimated 1.7 million taxpayers applied for a RAL in 2017. It is unknown how many of these applications were approved and whether all of these RALs were "no-fee." In comparison, about 12.7 million consumers obtained RALs at the height of the industry in 2002.

Even though "no-fee" RALs do not impose a fee directly on the consumer, they could present costs and risks for consumers. The lenders charge the tax preparers a fee of $35 to $45 for these RALs. Preparers might pass along these fees, or charge even more, by increasing their tax preparation fees or by charging separate "add-on" junk fees. Also, some lenders, such as EPS and River City Bank, appear to actually impose a price for "no fee" RALs by charging a higher price for a RAC if the preparer was offering these loans.

In addition to a no-fee RAL, one lender (MetaBank) is offering a second loan that is secured by the tax refund, and does charge an interest rate. The interest rate is 29.9%, which is below the traditional 36% usury cap for small loans in many states.

Perhaps the biggest cost of no-fee RALs is the need to pay for tax preparation. If the taxpayer had been planning to go to a paid preparer in the first place, there would not be an additional direct cost. But if they were planning to use a free resource such as a Volunteer Income Taxpayer Assistance (VITA) site or prepare their taxes themselves, they cannot do so if they want a no-fee RAL. In order to obtain a no-fee RAL, they must use a paid tax preparer and pay preparation fees of anywhere from $75 to several hundred dollars.

Tax Refund Delays

Last year, many low-income taxpayers faced an unpleasant surprise – their refunds were delayed due to the Protecting Americans from Tax Hikes (PATH) Act. The Act requires the IRS to delay refunds to taxpayers claiming the EITC or ACTC and the IRS must delay the entire refund – even the portion not associated with the EITC and ACTC – until mid-February.

Tax refunds will be similarly delayed this year. While the IRS must hold EITC/ACTC refunds until mid-February, the IRS has cautioned that the earliest that these refunds will likely arrive in bank accounts or via prepaid cards is February 27. Information on the timing of EITC/ACTC refunds is available from the IRS. The Consumer Financial Protection Bureau (CFPB) has advice on dealing with financial issues arising from the delay.

Lack of Minimum Competency Standards for Preparers

Lack of minimum standards for paid tax preparers continues to be a serious problem plaguing taxpayers. In all but a handful of states, paid tax preparers are not required to meet any minimum educational, competency, or training standards. Previously, only California, Maryland, New York, and Oregon imposed minimum competency standards on preparers who were not otherwise credentialed as attorneys, certified public accountants (CPAs) or IRS-tested enrolled agents. Connecticut has joined these four states by passing a law in 2017 requiring preparers to obtain a permit from the state Department of Revenue Services. Starting in 2020, this permit will require Connecticut preparers to obtain a certification from the IRS, which is otherwise voluntary for preparers in other states.

The lack of competency standards for paid tax preparers exposes consumers to potential errors 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 instances of fraud, ranging from 25% to over 90%.

A national poll released in March 2017 and commissioned by the Consumer Federation of America (CFA) found that more than two-thirds of consumers believe that tax preparers are already licensed, while only 20 percent believe they are not. Thus, most Americans believe that they are being protected against incompetent tax preparation, when the reality is that no such protections exist in 45 states.

The CFA poll also reveals broad public support for government oversight of tax preparers, with more than 4 out of 5 respondents believing 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. The complete results of the poll are available at: http://bit.ly/2nJirgJ

"Minimum competency and training standards need to be adopted in the 45 states that don't have them," **recommended Michael Best, senior policy advocate at the Consumer Federation of America**. "Taxpayers deserve no less."

If a taxpayer is determined to get a "no fee" RAL, advocates advise that it is even more critical to choose a preparer very carefully. "Taxpayers seeking a no fee RAL have twice the reason to be cautious in selecting a preparer, both to avoid incompetent and fraudulent preparers and to prevent being charged hidden fees," **stated Wu**.

Questions Taxpayers Should Ask Their Tax Preparers

- What kind of training do you have in tax preparation? Have you taken formal classes or a course in tax preparation?
- How long have you been preparing taxes?
- Do you have any credentials (attorney, CPA, enrolled agent or completing voluntary IRS certification)?
- How much will I be charged for tax preparation? Will I be charged more if I get a loan or an "advance"?
- Are there any other fees that I will be charged?

Taxpayers may wish to consider a credentialed preparer, such as a Certified Public Accountant, an enrolled agent, an attorney, or a preparer who has voluntarily completed the IRS Annual Filing Season Program. A directory of credentialed preparers is available on the IRS website. An infographic by CFA offers tips on Choosing Your Preparer Wisely.

A free or inexpensive alternative for low-income taxpayers is a free tax preparation site. These include VITA sites (1-800-906-9887 or https://irs.treasury.gov/freetaxprep/) and AARP Tax-Aide sites (www.aarp.org/findtaxhelp). Choosing a VITA or AARP Tax-Aide site saves eligible taxpayers the cost of a tax preparation fee. Many VITA sites can also help taxpayers open a bank account or get a low-cost prepaid card, which enables taxpayers to get refunds faster via direct deposit without paying a fee. Free tax preparation may be available on military bases as well.

Private Debt Collectors Squeeze Financially-Strapped Taxpayers over Tax Debts

The IRS is required by a 2015 law to outsource collection of certain tax debts to private collectors, which it began doing in 2017. A study by the National Taxpayer Advocate found that 44% of taxpayers who made payments to the IRS after being subjected to private debt collectors had incomes below 250% of the poverty level ($24,200 for a family of four), and 28% made less than $20,000 per year. Meanwhile, in 2017, the IRS private debt collection program cost $20 million to operate while only generating $6.7 million in revenue.

"The IRS private debt collector program is the epitome of waste and abuse in government programs," **stated Wu**. "Forcing the IRS to use private debt collectors to put the squeeze on vulnerable low-income families simply lines the pockets of these private collectors while jeopardizing the economic well-being of families and wasting taxpayers' money."

The IRS has tried using private collectors twice before and both attempts were big money-losers. The first attempt in the mid-1990s was scrapped a year after the program was launched, after losing $17 million. The second experiment began in 2006 and ended three years later after a net loss of almost $4.5 million to the government. This third attempt has resulted in a $13.3 million loss this past year, and private collectors have only managed to collect less than 1% of the $920 million in tax debts assigned to them.

Private debt collectors collecting IRS debts are subject to the federal Fair Debt Collection Practices Act (FDCPA), including the consumer's right to send the collector a written request to stop contacting the consumer. The FDCPA protects consumers against harassment and deception and provides consumers with the right to take legal action. To find a lawyer specializing in the FDCPA, consumers can consult an online directory made available by the National Association of Consumer Advocates.

Individual Taxpayer ID Number Renewals Mandated by Congress

An Individual Taxpayer Identification Number (ITIN) is used by anyone who is required to file a tax return or pay taxes under U.S. law but is not eligible for a Social Security number, including undocumented immigrants, who are still required to file tax returns. A second change mandated by Congress in the PATH Act is a requirement for all ITINs issued before 2013 to be renewed on a rolling basis.

An estimated 400,000 taxpayers were required to renew their ITINs last year, yet only 176,000 did so. This year, three times as many taxpayers will be required to do so, because 1.2 million ITINs that were recently used on a tax return expired on January 1, 2018. These include:

- Any ITIN with middle digits of either 70, 71, 72 or 80 (e.g., 9NN-71-NNNN)

- Any ITIN not used on a tax return at least once in the past three years

Additional ITINs will expire next year and will need to be renewed.

These taxpayers should renew their ITINs by submitting a completed Form W-7 to the IRS. If they file a tax return without renewing their ITIN, they will be ineligible for certain tax credits and exemptions and no refund will be paid until the ITIN is renewed. Last year, 152,000 taxpayers had their returns flagged for using an expired ITIN.

Once the ITIN is renewed, any exemptions and credits will be processed and any allowed refund will be paid. The IRS has estimated that it can take 9 to 11 weeks to process an ITIN renewal during the peak period of January 15 to April 30. Visit the IRS website for more information on ITIN renewals.

Related Resources

Press Release: Private IRS Collectors Waste Taxpayer Money While Squeezing Low-Income Families, Jan. 11, 2018

Report: *Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges*, March 2017

Report: *Public Views on Paid Tax Preparation 2017: Strong Public Support Continues for New Consumer Protections to Prevent Errors and Fraud*, March 2017

Infographic: Choosing Your Preparer Wisely!, April 2016

Report: *Prepared in Error: Mystery Shoppers in Florida and North Carolina Uncover Serious Tax Preparer Problems*, April 2015

Report: *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do*, March 2014

State Model Law to Ensure Competent Paid Tax Preparers

###

The **Consumer Federation of America** is an association of nearly 300 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education. http://www.consumerfed.org