



Consumer Federation of America

NATIONAL  
CONSUMER LAW  
CENTER INC

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## **QUICK TAX LOANS SKIM BILLIONS FROM TAXPAYER REFUNDS**

*Consumer Groups Warn Taxpayers to Avoid High-Cost Fast Tax Loans;  
About 12 Million Sold To American Taxpayers in 2004*

BOSTON – The W-2s have all been sent and it's the height of the tax season in poor communities, especially for the millions of working families who get the Earned Income Tax Credit (EITC). Yet again, tax preparers and their partner banks will be siphoning off hundreds of millions of dollars from these refunds by selling high cost refund anticipation loans (RALs).

The National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) estimate that approximately 12.38 million American taxpayers spent an unnecessary \$1.6 billion in 2004 (the latest year for which data is available) to obtain their refund monies faster by two weeks or less than if they used electronic filing and direct deposit. NCLC and CFA today issued their latest annual report on the RAL industry, entitled "Another Year of Losses: High-Priced Refund Anticipation Loans Continue to Take a Chunk Out of Americans' Tax Refunds."

"RALs are a bad deal for taxpayers, who can save themselves over a billion dollars by avoiding these exorbitantly priced loans," says NCLC staff attorney Chi Chi Wu. Advice for consumers on better alternatives to RALs is available in the NCLC brochure "Don't Pay to Borrow Your Own Money," attached and also on-line at [www.consumerlaw.org/initiatives/refund\\_anticipation/content/RALBrochure.pdf](http://www.consumerlaw.org/initiatives/refund_anticipation/content/RALBrochure.pdf).

### **RALs Examined**

RALs are extremely high-cost bank loans secured by the taxpayer's expected tax refund - loans that last about 7-14 days until the actual IRS refund repays the loan. The fact that the loans last for such a short period of time shows how unnecessary most RALs are: Taxpayers can get their refunds in two weeks or less even without the costly loan.

"If you want a fast and free refund, you can get it in two weeks or less by using electronic filing and having refunds direct deposited into your own bank account," says Jean Ann Fox, director of consumer protection for CFA, "If you don't have a bank account, getting a big refund is a good time to open one up."

RALs cost from \$29 to \$120 in loan fees. Some tax preparers also charge a separate fee, often called an “administrative” or “application” fee; however, this fee will become less common now that the largest commercial preparer chains have eliminated it for all or some of their offices. Tax preparers and their bank partners also offer an “instant” same day RAL for an extra \$20 to \$45.

The effective annual interest rate (APR) for a RAL can range from about 40% (for a loan of \$9,999) to over 700% (for a loan of \$200). If administrative fees are charged and included in the calculation, RALs cost about 70% to over 1,800% APR.

RAL usage has stayed flat, but the numbers are still alarmingly high. Using the most recent data available from the Internal Revenue Services (IRS), NCLC and CFA calculate that somewhere in the neighborhood of 12.38 million taxpayers received RALs in the 2004 tax filing season (for tax year 2003).<sup>1</sup> For that year alone, about 1 in 10 tax returns involved a RAL. These 12.38 million RALs represent a slight increase from the 12.15 million RALs taken in 2003. These consumers paid a total of \$1.24 billion in loan fees, plus \$360 million in administrative fees (since they were still being charged in 2004), for these loans.

This year, a RAL for the average refund of around \$2,150 will cost about \$100. A loan under those terms bears an effective APR of about 178%. If the taxpayer goes to a preparer who charges an additional \$30 administrative fee, the effective APR including the administrative fee would be 235%. These loan charges are in addition to tax preparation fees averaging \$146, so the grand total could be as high as \$276.

### **RALs Target Working Families**

The biggest target for RALs are the low-wage workers who claim the EITC. RALs drain hundreds of millions of dollars from the EITC, lining the coffers of multi-million dollar corporations with tax dollars meant for poor families with children. Over 56% of all RAL borrowers are EITC recipients according to IRS data, despite the fact that EITC recipients only make up 17% of taxpayers. One out of every three EITC recipients gets a RAL.

“This is a form of corporate profiteering,” stated NCLC’s Chi Chi Wu. “It’s a shame that big banks and commercial preparers pocket a chunk of anti-poverty benefits meant to help hardworking Americans.”

Based on IRS data for 2004, NCLC and CFA estimate that 7 million working poor families spent over \$900 million in RAL fees in order to get their tax refund monies less than two weeks sooner than they otherwise could. These families paid about \$700 million in RAL loan fees and \$204 million in administrative fees. In terms of other fees, these families paid \$1 billion in tax preparation fees, and about 45% of them spent approximately \$205 million to cash their RAL checks with check cashers.

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<sup>1</sup> The IRS data may not be precise, so these are ballpark figures. For those interested, the NCLC and CFA report explains the potential variance in the data.

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee (inc. dummy account fee)	\$100	\$700 million
Application/Admin. Fee (for 91%)	\$32	\$204 million
<b>Total</b>	<b>\$132</b>	<b>\$904 million</b>
Tax preparation fee	\$146	\$1 billion
Check cashing fee (for 45% of EITC recipients)	\$65	\$205 million
<b>Total with tax preparation and check cashing</b>	<b>\$343</b>	<b>\$2.1 billion</b>

### Data on RAL Users

A telephone polling survey commissioned by the Consumer Federation of America provides new information about RAL users. The national survey found that RAL users are vulnerable to quick cash loan offers. RAL users are more likely than non-RAL users to be less well educated, work in service or semi-skilled/unskilled jobs, rent instead of own their homes, be female and African American. RAL users are also heavier users than non-RAL users of other high cost fringe financial services, such as rent-to-own, payday loans and pawnshop loans. These consumers are more likely to be unbanked than non-RAL users and those who do have bank accounts are more likely to have overdrawn in the past year.

"Tax preparers are snaring cash-strapped families who can least afford to pay triple-digit interest rates for quick cash," said Jean Ann Fox of CFA. "Instead of getting RALs, EITC recipients need every dollar of their refunds to escape debt and set aside emergency funds."

The survey was conducted by Opinion Research Corporation in early November 2005 and interviewed 2,038 representative adult Americans. The margin of error for the sample is plus or minus two percentage points.

### Free File

A significant development in 2005 occurred when the IRS renewed its agreement with the Free File Alliance to provide for free Web-based electronic filing for taxpayers who make less than \$50,000 annually. Unfortunately, this new agreement does not ban Free File commercial preparers from marketing RALs to taxpayers. Since taxpayers reach Free File preparers by going through [www.irs.gov](http://www.irs.gov), the agreement continues to permit the appearance of an implicit government endorsement of the marketing of RALs and other ancillary products, such as audit "insurance" or preparing state tax returns. This new agreement also will not benefit the millions of lower income consumers who are on the other side of the "digital divide" without computer and Internet access at home.

The NCLC/CFA Report notes that Congressional pressure was placed on the IRS to enter this agreement, including a threat to ban the agency from developing its own software to permit direct electronic filing. According to Chi Chi Wu of NCLC, "It's hard to believe that taxpayers can't file their taxes electronically directly with the IRS and must go through a third party. It's even harder to believe that some in Congress want to prevent the IRS from fixing this problem and moving into the 21st Century."

## **New Laws, New Products**

Several states have passed new laws to address RALs, including the first law in the nation to cap RAL loan rates. Connecticut passed a law to cap rates by prohibiting tax preparers from brokering RALs with over a 60% annual interest rate. On the other hand, Washington State passed a weak disclosure RAL law that gutted Seattle's better ordinance. Other states passing disclosure-only RAL laws include California, Nevada, and Oregon.

A new wave of RAL products has emerged – “pay stub loans” that are sold to consumer before the tax season begins. These pay stub loan products appear to be the response to the IRS progress, albeit delayed, in providing faster refunds. These products pose additional risk and costs to consumers, and create a “race to the bottom” by the RAL industry. In addition, pay stub loans will permit the industry to continue its drain on tax refunds and EITC dollars with usurious loans.

## **Risk to Consumers**

In addition to their high costs, RALs can be a risky proposition. A RAL must be repaid even if the taxpayer's refund is denied, is smaller than expected, or frozen (something that the National Taxpayer Advocate has noted happens to hundreds of thousands of taxpayers, particularly EITC recipients). If the taxpayer cannot pay back the RAL, the lender may send the account to a debt collector. The unpaid RAL will also show up as a black mark on the taxpayer's credit record. If the taxpayer applies for a RAL or other refund financial product from a commercial preparer next year, she may find that her next year's refund gets grabbed to repay this year's unpaid RAL debt.

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

CFA is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

The NCLC/CFA 2006 report on RALs is available at [www.consumerlaw.org/action\\_agenda/refund\\_anticipation/index.shtml](http://www.consumerlaw.org/action_agenda/refund_anticipation/index.shtml) and at [www.consumerfed.org](http://www.consumerfed.org).

## Ways to Save At Tax Time

Here are ways to take a pass on that RAL – most folks don't need one – and save money at tax time:

**E-File with Direct Deposit.** File your tax return electronically (E-file) to speed up your refund. Tell the IRS to deposit the refund directly into your bank account – you provide your account number right on your tax return. You can get a refund in about 10 days this way – without paying one cent extra for a loan. Some of the free tax preparation programs (called "VITA" sites) can file taxes electronically. If you have internet access, you may be able to get free tax preparation and electronic filing at "www.icanefile.org".

**Get a bank account.** If you don't have a bank account, open one up to take advantage of direct deposit. You can use a savings account to receive your tax refund, and maybe save some of it for a down payment on a house or a car, or to build a nest egg.

**Wait just a bit longer.** Do you really have to get cash from your tax refund today? Can you wait a few weeks to save almost \$100? If you have an urgent bill to pay, ask for more time until the tax refund check comes from the IRS. Don't take on a new expensive debt to pay an old bill.

**Avoid check cashers.** Check cashers charge an extra fee to cash RAL and tax refund checks. Some check cashers charge up to 7% to cash a RAL check – the average is about 3%. So if you receive a \$2,000 refund, it would cost you an av-

erage of \$60 to cash the RAL check — on top of the RAL and tax preparation fees. A smarter move is to use a bank account.

## Save \$ and Avoid RALs – Use a VITA Site

A great way to save money at tax time is to go to a Volunteer Income Tax Assistance (VITA) site. VITA sites provide free tax preparation to low- and moderate-income taxpayers. VITA sites are sponsored by the IRS and can be found in libraries, community centers, and other locations during tax time.

For the nearest VITA site, call the IRS general help line at 1-800-TAX-1040 or go to [www.tax-coalition.org](http://www.tax-coalition.org).

The following is a VITA site serving your community:

77 Summer Street • 10<sup>th</sup> Floor  
Boston, MA 02110  
(617) 542-8010  
Fax: (617) 542-8028  
[www.consumerlaw.org](http://www.consumerlaw.org)



## Don't Pay to Borrow Your Own Money

The Risks and  
Costs of **Tax  
Refund  
Anticipation  
Loans**

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# Don't Pay to Borrow Your Own Money

## The Risks and Costs of Tax Refund Anticipation Loans

### The "Tax Refund" That Really Isn't One: It's a Refund Anticipation Loan

How would you like to pay a super-high price to borrow money that already belongs to you? Sounds ridiculous, right? But that's pretty much what happens to many folks at tax time in the crazy world of RALs, or refund anticipation loans.

You may be tempted by tax-time advertisements for "Fast Cash Refunds," "Express Money," or "Instant Refunds." These ads will offer to get you your refund in just a day or two, or even on the spot. Beware! Many of these "fast refunds" are really LOANS, refund anticipation loans.

When you get a RAL, you're borrowing against your own tax refund money. And RALs are often marketed to people who need money the most — low- and moderate-income workers who receive the Earned Income Tax Credit.

### Don't Pay Triple-Digit Interest Rates to Borrow Your Own Refund

RALs are extremely expensive. Loan fees typically range from \$30 to \$90, which translates into Annual Percentage Rates (APRs) of about 60% to over 700%. If you paid those rates on all your borrowing you'd probably go broke! And all to get your tax refund just a few days earlier than you can

for free from the IRS. You're lining someone else's pockets with YOUR hard-earned money!

RAL fees, combined with tax preparation, electronic filing, and other fees, can end up eating away a big chunk of your refund.

### RALs Can Be Hazardous to Your Financial Health

In addition to their high costs, RALs can be risky. Since a RAL is a loan from a bank in

partnership with a tax preparer, it must be repaid *even if the IRS denies or delays your refund, or your refund is smaller than expected*. If you don't pay back the RAL, the lender will take actions to hurt your credit rating and may send your account to a debt collector. In addition, when you apply for a RAL, you are giving the lender the right to grab your tax refund to pay for old tax loan debts that the lender claims you owe.

### Example:

For a tax refund of \$2000, you might pay to get a RAL:

RAL loan fee:	\$75
Electronic filing fee:	\$40
Combine that with the fee you will need to pay to the tax preparer:	<u>\$100</u>
<b>Total:</b>	<b>\$215</b>

This is **over 10%** of your refund!

This RAL has an APR (Annual Percentage Rate) of **142%** if it beats the IRS by 10 days.

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