



Consumer Federation of America

NATIONAL
CONSUMER LAW
CENTER

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Contact:
Chi Chi Wu, NCLC, 617-542-8010
Jean Ann Fox, CFA, 757-867-7523

DOWN, BUT NOT GONE: QUICK TAX REFUND LOANS CONTINUE TO GOUGE TAXPAYERS AND MILITARY

*Number of Refund Anticipation Loans Declined in 2005;
Nearly 10 Million Still Sold To American Taxpayers*

BOSTON – The W-2s have all been sent and tax season is in full swing in poor communities and around military bases, especially for the millions of working families who get the Earned Income Tax Credit (EITC). For another year, tax preparers and their partner banks will be draining 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 9.6 million American taxpayers spent \$960 million in loan fees, plus over \$100 million in other fees, in 2005 (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 “One Step Forward, One Step Back: Progress Seen in Efforts Against High-Priced Refund Anticipation Loans, but Even More Abusive Products Introduced.”

While the report found that still too many Americans lose precious tax dollars to high cost RALs, it also contains some good news on the effort to combat them. The number of RALs dropped by a dramatic 22% from 2004 to 2005. Industry giant H&R Block has lowered prices for some of its RALs, when deposited into its new debit card-based account. On the other hand, the industry has also unveiled new products called holiday and pay stub RALs that drain even more dollars from the pockets of low-income Americans and put them at greater risk of unmanageable debt.

“We’ve seen some movement to bring down the cost and number of RALs, at least from some segments of the industry, which is a good development” says NCLC staff attorney Chi Chi Wu. “However, almost 10 million taxpayers lost a chunk of their refunds for a quickie loan, a number that is still too high. Plus, RALs expose taxpayers to the risk of unmanageable debt if their refunds don’t arrive as expected.”

RAL Lending to Service Members

The men and women of our nation's armed forces are a prime target for RALs, according to a Department of Defense report to Congress on predatory lending. The NCLC and CFA report estimates that military Service members paid an estimated \$10 million out of their refunds (including EITC and Child Tax Credit benefits) for these loans. The report includes maps of RAL facilitators in two states (North Carolina and Washington State) which demonstrate how businesses that promote and broker RALs cluster around military bases.

The recently enacted Military Lending Act should protect Service members from high cost loans, including RALs. However, banks have been advocating to the Department of Defense that they be exempted from the new law.

"RAL lenders cluster around bases and charge Service members high rates for risky loans," Jean Ann Fox, director of consumer protection for CFA stated. "We urge the Department of Defense to apply its new military predatory lending protections to bank tax loans that drain over a million dollars from the pockets of Service members and their families every year."

RALs Examined

RALs are bank loans secured by the taxpayer's expected refund -- loans that last about 7-14 days until the actual IRS refund repays the loan. That's the first indicator of just how unnecessary most RALs are: Most taxpayers could have their refund 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. You can also save yourself some check cashing fees for that refund check."

RALs cost from about \$30 to over \$125 in loan fees. Some independent tax preparers also charge a separate fee, often called an "application" or "document processing" fee, up to \$40. The effective annual percentage rate (APR) for a RAL can range from about 40% to over 500%. If application fees are charged and included in the calculation, the effective APRs range from about 57% to over 1,100%.

Consumer use of RALs dropped significantly in 2005, but remain at disturbingly high levels. Using the most recent data available from the IRS, NCLC and CFA calculate that approximately 9.6 million taxpayers received RALs in the 2005 tax filing season (for tax year 2004). For that year alone, about 1 in 13 tax returns involved a RAL. Although high, these 9.6 million RALs represent a significant decline from the 12.4 million RALs reported for 2004 (for tax year 2003). The NCLC/CFA report discusses potential reasons for this decline, including improved data reporting to the IRS, increased public scrutiny around RALs, better consumer awareness, and free tax preparation alternatives. However, there is no definitive answer as to why this dramatic drop occurred.

This year, we have finally seen some competition in RAL pricing, which in the past has been within a few dollars between industry players. In particular, H&R Block has lowered the

fee for RALs in the range of \$1,000 to \$4,000, if the consumer chooses to receive the RAL on a Block Emerald Card. Block has reported that all of its RALs bear an APR of 36%; however, that figure does not include the fee for the temporary “refund account” of \$30 in its calculation. If the refund account fee is included, the APR increases significantly, especially for smaller RALs. Nonetheless, this represents a substantial price drop for mid-tier RALs

Thus, in 2007, a consumer can expect to pay from \$57 to \$104 to \$111 in order to get a RAL for a typical refund of about \$2,500. The effective APR for this RAL would be 85% to 150% to 170%. The RAL loan fee is in addition to tax preparation fees averaging \$150 and, in some cases, an application fee of about \$40. The major commercial chains have stopped charging this fee, but independent tax preparers may charge a fee and they have a substantial portion of the tax preparation market.

Even Faster, Even Costlier RALs

Tax preparers and their bank partners also offer an “instant” same day RAL for an additional fee, from \$25 to \$55. In addition, the industry has been pitching “holiday” and “pay stub” RALs, which are made prior to the tax filing season, before taxpayers receive their IRS Form W-2s and can file their returns. Pay stub RALs are made in January using the year-end pay stub information, while holiday RALs are made by tax preparers during November and December.

Pay stub and holiday RALs present additional costs and risks to taxpayers. In addition, they may continue the ability of the RAL industry to drain tax refunds even after the IRS is able to speed refund delivery times to a few days. NCLC and CFA issued a report in November 2006 on these products, available at www.consumerlaw.org/action_agenda/refund_anticipation/content/PaystubRALsReport.pdf.

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 60% of all RAL borrowers are EITC recipients according to IRS data, despite the fact that EITC recipients only make up 17% of taxpayers. About 30% of EITC recipients get a RAL.

“EITC taxpayers are hard working people, many with children,” stated NCLC’s Chi Chi Wu. “They need every dollar of these anti-poverty benefits, including those skimmed off by RALs.”

Based on IRS data for 2005, NCLC and CFA estimate that 5.9 million working poor families spent over \$600 million in RAL fees in order to get their tax refund monies two weeks or less sooner than they otherwise could. These families paid about \$590 million in RAL loan fees and some of them spent another \$59 million in document processing fees. In terms of other fees, these families paid \$885 million in tax preparation fees, which they could have saved by going to a free tax preparation program. Both the Volunteer Income Tax Assistance (VITA) program and AARP’s TaxAide offer free tax preparation for low-income taxpayers. The IRS Free File program is available for taxpayers who earn \$52,000 or less, and RALs are no longer marketed through that program. (www.irs.gov)

Bank Account Options

Some free tax preparation programs can also help taxpayers open bank accounts, which allow them to take advantage of the speed of a direct-deposited refund using electronic filing. This year the IRS is allowing taxpayers to electronically deposit their tax refunds in up to three accounts with Form 8888. Refunds can be split by depositing into both checking and savings accounts.

Bank accounts also save taxpayers the cost of check cashing fees. A survey of check cashing outlets by CFA member groups found that these outlets charged an average of 2.78% of the face value to cash tax refund checks, with fees ranging from 1% to 5.9%. Thus, for a \$2,500 tax refund check, the average check casher would charge \$69.50, while the most expensive outlet would charge \$147.50.

Tax preparers have been active in this area as well. H&R Block has unveiled the Emerald Card, a new electronic debit-card based bank account in which customers can direct deposit refunds. Jackson Hewitt and Republic Bank & Trust offer pre-paid debit cards.

Risks of RALs

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 into to a debt collector. The unpaid RAL will also show up as a black mark on the taxpayer's credit record.

Even worse, in the past taxpayers who owed unpaid RAL debts and then applied for a RAL or other refund financial product in a subsequent year often found that the subsequent year's refund was grabbed to repay the prior RAL debt -- a practice known as cross lender debt collection. Fortunately, there has been some reform around this practice. The California Attorney General reached a settlement with Jackson Hewitt that requires the company to inform consumers if they owe prior unpaid RALs and that if they apply for a RAL or RAC, the proceeds will be used to satisfy this debt. JPMorgan Chase has stated it will cease cross collection altogether, except for a remaining 1 year for HSBC past due RALs. H&R Block has unveiled a new "debt alert" service that informs clients about a possible prior RAL debt and provides access to a toll-free number to HSBC for more information.

Another risk of RALs is that information from tax returns will be shared with the lending bank when consumers apply for the loans. As long as a taxpayer signs the right form, IRS rules permit tax return information to be shared with a third party. The IRS held public hearings in April 2006 on proposed changes to its privacy rules but has not issued new rules for this tax season.

Other Progress in Anti-RAL Efforts

This past year has seen other significant developments in efforts against RALs. RALs were dropped from the IRS Free File program, which provides for free Web-based electronic filing for taxpayers who make less than \$52,000 annual adjusted gross income. For years, consumer advocates had urged the IRS to prohibit RAL marketing in Free File. They had argued that since taxpayers reach Free File by going through www.irs.gov, RAL marketing in Free File created an implicit government endorsement of the loans.

There was a tremendous amount of anti-RAL advocacy in many parts of the country, including other national groups and groups in California, Illinois, New York City, North Carolina, and Philadelphia. Some of these groups actively coordinated their efforts, including a joint protest outside of Jackson Hewitt's headquarters in New Jersey. These groups and other organizations also issued their own state or city-specific reports on RALs.

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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.