



# **Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Taxpayers At Risk**

## **The NCLC/CFA 2009 Refund Anticipation Loan Report**

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### **EXECUTIVE SUMMARY**

Refund anticipation loans (RALs) are 1 to 2 week loans made by banks and facilitated by tax preparers, secured by the taxpayer's expected tax refund. RALs can carry triple digit APRs, and expose taxpayers to the risks of unpaid debt if their refunds do not arrive as expected.

This report contains the annual update on the RAL industry from the National Consumer Law Center and Consumer Federation of America. It also includes a special Appendix discussing RALs, tax fraud, and fringe tax preparers. The Appendix reviews extensive evidence indicating that RALs provide tax preparers with an incentive to inflate

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Consumer Federation of America is a non-profit association of about 300 groups, with a combined membership of over 50 million people. CFA was founded in 1968 to advance consumers' interest through advocacy and education.

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refunds and commit tax fraud. It also documents how RALs attract payday loan stores, check cashers, used car dealers, and other questionable businesses into the field of tax preparation, sometimes with less than competent or savory results.

Some of the findings from this report include:

- RAL volume remained high and steady from 2006 to 2007. Tax preparers and their bank partners made approximately 8.7 million RALs during the 2007 tax-filing season compared to 9 million in 2006, and a high of 12.4 million in 2004.
- Consumers paid an estimated \$833 million in RAL fees in 2007 to get quick cash for their refunds – essentially borrowing their own money, sometimes at extremely high interest rates. This price tag declined from \$900 million in 2006, due in part to a price cut by H&R Block for about half of its customers in 2007. In 2008, Block expanded this price cut, while JP Morgan Chase also lowered its prices.
- In addition to RAL fees, consumers paid another estimated \$68 million in “application,” “administrative,” “e-filing,” “service bureau,” “transmission,” or “processing” fees. Since the major preparation chains do not charge these fees, we based this estimate on an assumption that about 20% of RAL borrowers are charged this fee.
- The price of a RAL for a typical RAL of \$3,000 can range from \$62 to \$110. Thus, taxpayers should be advised to avoid RALs, but if they insist on getting one, they should shop around.
- The APRs for RALs can still range in the triple digits. H&R Block and JPMorgan Chase claim that their RALs carry an APR of 36%, but that calculation does not include the fee for the dummy bank account used to repay the RAL, which doubles the APR. Other tax preparers, such as Jackson Hewitt and Liberty Tax Service, continue to offer high cost RALs with APRs in the triple digits. The effective APR for RALs based on a 10-day loan period ranges from about 50% (for a loan of \$10,000) to nearly 500% (for a loan of \$300). The APR for a typical RAL of about \$3,000 can be from 77% to 140%.
- Pay stub RALs made a re-appearance at H&R Block and Jackson Hewitt offices. These loans, which are made prior to the beginning of the tax filing season and repaid by the tax refund or RAL during tax season, are risky for borrowers. They may also increase the cost of tax-related loans for some borrowers, and require them to return to the same preparer for tax preparation.
- The Second Circuit Court of Appeals issued a major decision hampering the ability of states to regulate RALs. The Second Circuit held that federal banking law preempted the interest rate caps of the Connecticut RAL law, despite the fact that the law does not regulate what the banks can charge, but only prohibits third-

party tax preparers from facilitating RALs over 60% APR. If the Second Circuit is correct, only Congress can act to limit RAL fees. In response to the Second Circuit's decision, NCLC has issued a revised Model RAL law that focuses on the abuses that states can still regulate.

- State regulators have continued to take enforcement action over abusive aspects of RALs other than their fees. The California Attorney General settled a lawsuit against H&R Block over its promotion of RALs. Block promised to pay \$4.9 million in refunds and penalties. The New Jersey Attorney General took action against 38 tax preparers for deceptive advertising of RALs. The New York State Division of Human Rights continued its lawsuits alleging discriminatory targeting by tax preparers offering RALs.
- Government investigators and consumer/advocacy groups issued several significant studies documenting RAL abuses as well as incompetent tax preparation. Consumer/advocacy groups conducted mystery shopper testing in Philadelphia, Durham, NC, and Alabama. The Treasury Inspector General for Tax Administration conducted a survey of RAL borrowers finding that 85% would be willing to wait up to nine days to receive their refund directly from the IRS, and that the IRS' average time for an e-filed, direct deposit refund is 10 days. The same agency also conducted mystery shopping of tax preparers, finding many did not prepare an accurate return. The Government Accountability office conducted a survey of tax preparers offering RALs, finding a significant number working out of retailers and fringe financial providers, some of which offered incentives to spend their refunds at the storefront.
- The IRS took a tentative step toward RAL reform, asking whether it should limit RALs by restricting the tax information sharing necessary to make the loans. The IRS asked for information about whether RALs and RACs provide an incentive for preparers to improperly inflate refunds. NCLC, CFA and others submitted extensive evidence that such an incentive exists. Subsequently, the IRS conducted its own study, which found a significant correlation between RALs and "noncompliance" – RAL users are 27-36% more noncompliant than taxpayers who do not use a financial product.
- RALs and RACs also allow tax preparers to obfuscate the price of tax preparation. Tax preparation fees are almost always deducted from the RAL or RAC proceeds, making taxpayers less sensitive to their costs. This permits preparers to resist giving a firm quote for the price of preparation. It also allows them to pad their fees with extra "add-on" charges, such as document preparation, application, e-file, transmission, and other fees. One software provider for tax preparers brazenly recommends "lowballing" tax preparation charges to get the customer in the door, then charge more in add-on fees to make up for the "lowball" price.

## PART I. OVERVIEW AND NUMBERS

Refund anticipation loans (RALs) are loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs usually run for a duration of about 7-14 days (the difference between when the RAL is made and when it is repaid by deposit of the taxpayer's refund), fees for these loans can translate into triple digit Annual Percentage Rates (APRs).

RALs drain hundreds of millions of dollars from the pockets of consumers and the U.S. Treasury. They target the working poor, especially those who receive the Earned Income Tax Credit (EITC), a refundable credit provided through the tax system and intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, providing nearly \$43.7 billion to 22.4 million families in 2007.<sup>1</sup>

This report updates the NCLC/CFA annual reports on the RAL industry and the drain caused by RALs from EITC benefits. Those interested in background information on the industry and regulation should refer to the first NCLC/CFA RAL Report published in January 2002.<sup>2</sup> In addition to our yearly reports, we have issued special reports on the IRS Debt Indicator,<sup>3</sup> "pay stub" RALs,<sup>4</sup> a rebuttal of industry-funded RAL studies,<sup>5</sup> and mystery shopper testing of RAL providers in Philadelphia/Durham, NC.<sup>6</sup>

RAL volume has remained steady, but price decreases in 2007 reduced the total price paid for RALs. The volume of RALs in 2007, the most recent year for which the IRS has comprehensive data, was about 8.7 million, similar to a year ago. However, the amount paid for RALs declined from \$900 million to \$833 million, due to a price drop implemented by H&R Block for about half of its customers who received RALs on Block's Emerald Card. Unfortunately, we have seen the return of "pay stub" and "holiday" RALs in 2009. In addition, Block discontinued its military RAL, which was the only truly 36% APR RAL on the market, citing inability to reach agreement with HSBC.

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<sup>1</sup> Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>2</sup> Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, *Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury*, National Consumer Law Center and Consumer Federation of America, Jan. 31, 2002, [hereinafter "NCLC/CFA 2002 RAL Report"], available at [www.consumerlaw.org/issues/refund\\_anticipation/content/RAL\\_final.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/RAL_final.pdf).

<sup>3</sup> Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*, National Consumer Law Center (July 2005), available at [www.consumerlaw.org/issues/refund\\_anticipation/content/Debt\\_Indicator\\_White\\_Paper.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/Debt_Indicator_White_Paper.pdf).

<sup>4</sup> Chi Chi Wu and Jean Ann Fox, *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom* National Consumer Law Center and Consumer Federation of America, Nov. 2008.

<sup>5</sup> Appendix A to Chi Chi Wu, Jean Ann Fox, and Patrick Woodall, *Another Year of Losses: High-Priced Refund Anticipation Loans Continue To Take a Chunk Out Of Americans' Tax Refunds*, National Consumer Law Center and Consumer Federation of America, Jan. 2006, at 4 [hereinafter "NCLC/CFA 2006 RAL Report."].

<sup>6</sup> Chi Chi Wu, Kerry Smith, Peter Skillern, Adam Rust, and Stella Adams, *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, April 2008 [hereinafter "Durham/Philadelphia Mystery Shopper Report"]

## A. RAL Volume Remains Steady

RAL volume remained steady from 2006 to 2007. The IRS data indicates there was a slight increase of 2% in the number of RAL applications from 2006 to 2007. About 1 in 15 taxpayers took out a RAL.<sup>7</sup>

Based on the IRS data, we estimate there were approximately 8.67 million RALs made in 2007. The IRS data reports that there were 10.2 million RAL applications in 2006.<sup>8</sup> However, not all RAL applications result in loans, as a certain percentage are rejected based on the IRS Debt Indicator or other criteria.

We had previously used a rejection rate of 10% for RAL applications, based upon published statements from HSBC and Santa Barbara Bank & Trust (SBBT).<sup>9</sup> However, industry representatives repeatedly insisted to us in 2007 that the actual industry-wide rejection rate is closer to 15%.<sup>10</sup> In addition, Liberty Tax Service stated in an analyst conference call that the rejection rate from its lender (SBBT) was 20% in 2007 and 30% in 2008.<sup>11</sup>

We will assume that 15% of RAL applications were rejected in 2007 given the industry's avowed and now written statements of an approval rate closer to 85%. However, to give a better indicator of RAL trends, we provide of table of RAL applications in addition to total RALs made, since estimates for 2000 to 2006 were based on the 90% approval rate. Note that even rejected RALs cost taxpayers a fee, because they are automatically given a refund anticipation check (RAC) at a cost of about \$30.

The following chart documents the trends in RAL applications since 2000:<sup>12</sup>

<b>Filing Year</b>	<b>No. of RAL applications</b>	<b>Increase/decrease from prior year</b>	<b>No. of RALs made</b>	<b>RAL loan fees</b>
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

<sup>7</sup> There were 134 million returns filed in the 2007 filing season, which was for Tax Year 2006. Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>8</sup> Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>9</sup> Santa Barbara Bank & Trust, *Why You Should Choose SBBT '05*; Household International, *Exploring the Refund Anticipation Loan (RAL): Questions and Answers*, on file with the authors.

<sup>10</sup> E.g., Email from former HSBC Taxpayer Financial Services Marketing Director, Feb. 2, 2007, on file with the authors.

<sup>11</sup> *RAL Rejection Rates Rising: Jackson Hewitt Most Impacted*, Liberty Tax Service conference call, Feb. 19, 2008.

Preliminary information indicates that the number of RALs remained about the same as well for 2008, with 10 million RAL applications.<sup>13</sup> Interestingly, for 2009, there are indications that the number of RAL applications has actually decreased.<sup>14</sup>

In 2007, for taxpayers who received refunds, the average amount was about \$2,700.<sup>15</sup> For most RAL borrowers, the RAL loan fee for that loan amount was between \$104 to \$111 in 2007 (or an average of \$107.50).<sup>16</sup> However, starting in 2007, H&R Block dropped RAL loan fees for those customers who receive a RAL on the Block Emerald Card. Thus, about 2 million Block customers who received Emerald Cards (about 23% of the market) paid lower rates for a RAL, which would have been \$58 for the average refund of \$2,700.<sup>17</sup>

Assuming 6.67 million RAL borrowers paid about \$107.5 and 2 million paid \$58, taxpayers paid somewhere in the neighborhood of \$833 million in RAL fees in 2007. This compares to an estimated \$900 million in RAL fees in 2006<sup>18</sup> and the high of \$1.24 billion in RAL loan fees in 2004.<sup>19</sup>

The \$833 million for 2007 does not include the added fees paid for loan products that provide a RAL on the same day that the taxpayer's return is prepared. Lenders charge an additional \$25 to \$55 for same-day RALs, a fee which the consumer pays on top of regular RAL fees.<sup>20</sup> We know that H&R Block made 1.5 million "Instant Money" RALs in 2004.<sup>21</sup> Assuming a similar number in 2007, this adds at least another \$37.5 million to the RAL drain.<sup>22</sup> We do not have data on the number of same-day RALs made by the rest of the industry.

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<sup>12</sup> This chart is based on data from IRS SPEC and the annual RAL reports issued by NCLC and CFA.

<sup>13</sup> IRS, Weekly E-File At a Glance – U.S. Totals for Individual Returns, September 25, 2008, on file with authors.

<sup>14</sup> Millman Research Associates. *HRB JTX: IRS Tax Filing Data Very Surprising Thru 2/2/09*, Feb. 6, 2009, on file with authors.

<sup>15</sup> According to IRS data, 108 million taxpayers received refunds totaling \$290 billion in 2006. That averages to \$2,685 per taxpayer who received a refund. *Id.*

<sup>16</sup> Chi Chi Wu and Jean Ann Fox, *One Step Forward, One Step Back: Progress Seen in Efforts Against High-Priced Refund Anticipation Loans, but Even More Abusive Products Introduced*, National Consumer Law Center and Consumer Federation of America, Jan. 2007, at 10, 13. [hereinafter referred to as "NCLC/CFA 2007 RAL Report."]

<sup>17</sup> *Id.* at 9.

<sup>18</sup> 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 6. [Hereinafter "NCLC/CFA 2008 RAL Report"].

<sup>19</sup> NCLC/CFA 2006 RAL Report at 6.

<sup>20</sup> H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors; Santa Barbara Bank & Trust, *Bank Product Program 2009*, October 2008, on file with the authors; <https://www.republicrefund.com/Products/Pricing.aspx>, visited Feb. 22, 2008.

<sup>21</sup> Peter Tufano and Daniel Schneider, *H&R Block and "Everyday Financial Services,"* Harvard Business School, October 2004, at 7.

<sup>22</sup> Note that Block customers pay an additional \$25 for an Instant RAL. H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors. This is significantly less than the same-day RAL surcharge for other tax preparers; thus, the drain created by these products may even be greater if we had data on industry-wide sale.

In addition to the fee charged by the RAL lender, in the past, all of the major tax preparation firms had been charging their own separate fees for RALs, sometimes called a “document processing” or “application” fee. However, all three of the major tax preparation chains have dropped this fee

Despite this, there remains a significant sector of independent preparers that make RALs. Independent preparers have about 70-75% of the paid preparer market, and 40% of the RAL market.<sup>23</sup> Santa Barbara Bank & Trust has stated that it allowed preparers to charge a document processing fee up to \$40.<sup>24</sup> In addition, as discussed in Section I.B below, we have seen other add-on fees from independent preparers. These include “administrative,” “e-filing,” “service bureau” and “transmission/software” fees, which can add up to several hundred dollars.

We assume that about half of independent preparers charge document processing fees, which would equate to 20% of the RAL market or 1.7 million consumers. Using SBBT’s cap of \$40 – a very conservative limit given the proliferation of multiple fees – these add-on fees increased by about \$68 million the amount paid for RALs in 2007. Thus, taxpayers lost somewhere in the neighborhood of \$900 million collectively to get loans a mere one to two weeks sooner than they could have gotten their refunds from the IRS.

#### B. RAL Pricing

In 2008, H&R Block dropped the price of all of its RALs to 1.07% of the loan amount, plus \$29.95 for the “Refund Account Fee.”<sup>25</sup> This is the fee supposedly for the “dummy” bank account used to receive the consumer’s tax refund from IRS to repay the RAL. Block charges an additional \$20 if the consumer receives a paper check. If the customer chooses to receive the RAL by direct deposit or loaded onto Block’s Emerald Card, there is no additional fee. The Emerald Card is an electronic bank account based on a prepaid debit card platform.

Block’s pricing remained the same for 2009. Block asserts that its RALs now carry an APR of only 36%, which is a traditional maximum small loan rate cap for state usury laws. However, Block’s calculation of this APR does not include the \$29.95 it charges for the Refund Account. Most tax preparers and RAL lenders do not include this fee in the APR, claiming that it is comparable to the charge for the non-loan RAC. We have challenged this unbundling in the past, for reasons explained in past RAL reports.<sup>26</sup>

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<sup>23</sup> See Appendix A at Section II.A, *infra*; Jackson Hewitt Tax Service, *Investor Presentation – December 2006 Update*, November 22, 2006, at 8.

<sup>24</sup> Plaintiff’s Local Rule 56(a)(1) Separate Statement of Undisputed Facts at ¶8, n. 1, *Pacific Capital Bank, N.A. v. Conn.*, No. 3:06-CV-28 (D. Conn. Aug. 10, 2006).

<sup>25</sup> H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors.

<sup>26</sup> See NCLC/CFA 2004 RAL Report at 5.

If the dummy account fee is included, the APRs for Block RALs are much higher. They can be quite dramatically higher for the loans in the lowest tier (\$300 to less than \$1,000), in the triple digits. Nonetheless, Block’s prices are significantly lower than in past years and compared to other providers, especially for RALs in the range of \$1,000 to \$4,000 – the range in which most EITC refunds fall.

**H&R Block 2009 Sample RAL fees<sup>27</sup>**

Amount of Loan	Loan Fee
\$300	\$33.17
\$500	\$35.31
\$750	\$37.99
\$1,000	\$40.68
\$1,500	\$46.04
\$2,000	\$51.41
\$3,000	\$62.14
\$4,000	\$72.87
\$5,000	\$83.60
\$9,999	\$137.23

HSBC is the lender for RALs facilitated by H&R Block. Previously, HSBC had made RALs through Jackson Hewitt offices and independent preparers, but has ceased doing so.

The other industry player with significantly lower prices is JPMorgan Chase. Chase also charges a fee of about 1% of the loan amount plus \$32 for its version of the dummy bank account.<sup>28</sup> Chase’s loan fees are as follows.<sup>29</sup>

**JPMorgan Chase 2008 RAL Fee Schedule**

Amount of Loan	Loan Fee
\$300-\$1,000	\$35
\$1,500	\$47
\$2,000	\$52
\$3,000	\$62
\$4,000	\$72
\$5,000	\$82
\$9,999	\$131

While we are heartened by Block’s & Chase’s decrease in RAL prices, we are disappointed that the other RAL banks have not similarly lowered their prices.

<sup>27</sup> H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors.

<sup>28</sup> JPMorgan Chase, *Application/Agreement for Chase Refund Anticipation Loan and/or Bonu\$ Deposit Account – 2009*, on file with authors.

<sup>29</sup> *Id.*



Also, as discussed in our 2008 RAL report, Block and Chase's current RAL prices are not the lowest they have ever been.<sup>30</sup> In 1994, the price of a RAL was a flat fee of \$29 or \$35. If RAL prices had remained a flat fee comparable to \$29 or \$35, a RAL would only cost \$41.57 or \$50.17 in today's dollars (the equivalent of \$29 or \$35 in 1994 adjusted for inflation).<sup>31</sup>

Two other lending banks, SBBT and Republic Bank & Trust, have not lowered their prices for RALs over \$1,000. Jackson Hewitt uses both of these banks, and its RAL pricing apparently varies by office and lender.

Not only are SBBT's prices higher than Block and Chase, the bank has raised some of them. SBBT had lowered its RAL fees for RALs of \$300 to \$1,000 in 2008, but this year has raised them back to 2.5% of the loan amount, plus a dummy account fee of \$30.95.<sup>32</sup> For loans over \$4,000, SBBT charges \$100 plus the \$30.95 account fee.

**SBBT 2009 RAL Fee Schedule<sup>33</sup>**

Amount of Loan	Loan Fee
\$300	\$38.45
\$500	\$43.45
\$1,000	\$55.95
\$1,500	\$68.45
\$2,000	\$80.95
\$2,500	\$93.45
\$3,000	\$105.95
\$3,500	\$118.45
\$4,000-\$7,500	\$130.95

Republic Bank is a state-chartered bank based in Louisville, KY, that makes RALs through independent preparers. Republic lowered its prices this year for RALs of \$300 to \$1,000. However, Republic's prices have remained high for RALs over \$1,000:

**Republic 2009 RAL Fee Schedule<sup>34</sup>**

Amount of Loan	Loan Fee
\$300	\$34.16
\$500	\$36.30
\$1,000	\$41.65
\$1,500	\$70.70
\$2,000	\$83.95
\$2,500	\$97.20
\$3,000	\$110.45
\$3,500	\$123.70
\$3,699-\$8,000	\$128.95

<sup>30</sup> NCLC/CFA 2008 RAL Report at 9-10.

<sup>31</sup> Using the Department of Labor's inflation calculator at [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm).

<sup>32</sup> Santa Barbara Bank & Trust, *Bank Product Program 2009*, November 2008, on file with the authors.

<sup>33</sup> *Id.*

<sup>34</sup> <https://www.republicrefund.com/Products/Pricing.aspx>, visited Feb. 22, 2008.

A typical RAL would be around \$3,000 or more. Thus, for RALs in 2009, a consumer can expect to pay from \$62.14 (Block) to \$110.45 (Republic Bank). The effective APR for this RAL would be 77% (Block) to 140% (Republic Bank).

Preparer/Bank	RAL fee (including Refund Account Fee)	APR (inc. Refund Account Fee)	Application/ Administrative Fee	Total Fee	APR with Application Fee
H&R Block/HSBC	\$62.14	77%	None (but addn \$20 if a paper check is issued for the RAL)	\$62.14	77%
Jackson Hewitt <sup>35</sup>	\$105.95 or 110.45	134% or 140%	None	\$105.95 or 110.45	134% or 140% %
Independent Preparer /Santa Barbara Bank & Trust	\$105.95	134%	up to \$40	up to \$146	up to 187%
Independent Preparer/JPMorgan Chase	\$62	77%		\$62	77%
Independent Preparer /Republic Bank & Trust	\$110.45	140%	Unknown	---	at least 140%

The good news is that the price of RALs has declined significantly for some of the biggest players in the industry, introducing real price competition. Thus, while we advise taxpayers to avoid RALs in the first place, they should shop around if they insist on getting one.

Even with price cuts, RALs continue to represent a huge drain on the tax refunds of almost 9 million consumers. Moreover, the fee for the RAL comes on top of the fee for tax preparation, which averages \$183 for Block<sup>36</sup> and can be higher for other preparers.<sup>37</sup> Altogether, the consumer might pay about \$245 to \$293. If the consumer chooses a tax preparer that charges a “document processing” or “application” fee of \$40 per loan, the total would rise to as much as \$285 to \$333. A low-income taxpayer could save this entire amount and still receive a quick refund using direct deposit by choosing a free tax preparation program that offers e-filing.

<sup>35</sup> Based on pricing by SBBT or Republic.

<sup>36</sup> H&R Block Inc., *2008 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 25. [Hereinafter “H&R Block 2008 Form 10-K”].

<sup>37</sup> Tax preparation fees were as high as \$355 in mystery shopping conducted in Durham, NC and Philadelphia, PA. Durham/Philadelphia Mystery Shopper Report at Attachment 2.

For the 2009 filing season, the APRs on RALs vary widely given the divergence in pricing between the industry players. They can be anywhere from about 50% (for a loan of \$10,000) to almost 500% (for a loan of \$300).<sup>38</sup> We also continue to report a version of the APR that includes application or document processing fees, if they are charged, because those fees when charged also represent a cost of the credit for a RAL. For loans with document processing or application fees, the fees can translate into APRs of about 85% (\$10,000 loan) to nearly 1,300% (\$300 loan).

Tax preparers and their bank partners also offer an “instant” same day RAL for an additional fee, from \$25 to \$55. Some of the APRs for an instant RAL of around \$1,500 are 185% (Block) and 211% (Chase).

Consumers who do not use one of the commercial chains should also ask if the preparer charges any add-on fees. In addition to “application” and “document processing” fees, these include “e-filing,” “service bureau” and “transmission/software” fees. These fees can be very high, and are sometimes seen in conjunction with deceptive advertising of low prices for tax preparation. Examples include:

- Four of the six testers who went to non-chain independent preparers in mystery shopper testing conducted in Philadelphia and Durham, NC in 2008 were charged some sort of add-on fee. One tester was charged \$40 for document preparation, \$148 for e-filing, \$15 for “transmission” and \$120 as a “service bureau fee” – a total of \$324 in add-on fees. Several other testers were charged \$45.<sup>39</sup>
- A tax preparer in Baltimore advertised a \$36 tax preparation fee and “Faster and Cheaper than H&R Block/Jackson Hewitt” but then charged a consumer \$185 for an “electronic filing fee” and \$10 for a “transmission/software” fee – a total of \$195 in add-on fees.<sup>40</sup>
- A tax preparer in Florida charged \$65 for tax preparation, and then charged \$49 for a “RAL Processing Fee,” \$15 for a “Federal Electronic Filing Fee,” and \$10 for mysterious “Other charges” – a total of \$74 in add-on fees.<sup>41</sup>
- New York consumers sued a Jackson Hewitt franchisee that charged a hidden RAL fee of \$25 plus a disclosed \$75 “application” fee – for a total of \$100 in fees in addition to the RAL loan fee.<sup>42</sup>

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<sup>38</sup> These APRs are based upon a 10 day loan period. The estimated time provided by the federal government to receive a refund with e-filing and direct deposit is 8 to 15 days. IRS, *2008 IRS e-file Refund Cycle Chart*, Publication 2043, October 2007. The median time would be 11.5 days, and the loan itself takes one or two days to process. The Treasury Inspector General for Tax Administration’s analysis of IRS data confirmed that the average time for an e-file, direct deposit refund is 10 days. Treasury Inspector General for Tax Administration, *Many Taxpayers Who Obtain Refund Anticipation Loans Could Benefit from Free Tax Preparation Services*, Reference Number: 2008-40-170, Sept. 8, 2008, available at <http://www.ustreas.gov/tigta/auditreports/2008reports/200840170fr.pdf>.

<sup>39</sup> Durham/Philadelphia Mystery Shopper Report at Attachment 2.

<sup>40</sup> Comments of National Consumer Law Center, Consumer Federation of America, et al. regarding Advance Notice of Proposed Rulemaking - Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products, April 7, 2008, at 18, available at [http://www.consumerlaw.org/issues/refund\\_anticipation/content/comments\\_040708.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/comments_040708.pdf). [Hereinafter “NCLC/CFA Comments to IRS RAL ANPR”].

<sup>41</sup> *Id.*

- Testing by the Government Accountability Office in 2006 included examples of testers charged between \$479 to \$570 for a RAL of \$5,000, after subtracting the amount charged to prepare the return.<sup>43</sup> Since the RAL banks charged loan fees of about \$110 that year for a RAL of \$5,000, the preparers had added add-on charges of \$370 to \$460 on top of the loan fee.<sup>44</sup>

RAL lender Santa Barbara Bank & Trust allegedly limits tax preparers to \$40 in add-on fees; however, the preparer that charged \$324 in add-on fees used Santa Barbara as its lender.

### C. Impact on Low-Income Taxpayers and EITC recipients

RALs are mostly marketed to low-income taxpayers. According to IRS data, 85% of taxpayers who applied for a RAL in 2007 had adjusted gross incomes of \$38,348 or less.<sup>45</sup> Industry data similarly shows that most RAL borrowers are low to moderate income taxpayers.<sup>46</sup> A 2005 survey by CFA found that the majority of RAL borrowers (58.7%) earned below \$40,000.<sup>47</sup>

RALs continue to drain hundreds of millions of dollars from the Earned Income Tax Credit. IRS data shows that in 2007 nearly two-thirds (63%) of RAL consumers were EITC recipients, or 5.44 million families.<sup>48</sup> Yet EITC recipients made up only 17% of individual taxpayers in 2007.<sup>49</sup> Thus, EITC recipients are vastly overrepresented among the ranks of RAL consumers.

In addition, IRS data shows that 28.5% of EITC recipients applied for a RAL in 2007.<sup>50</sup> A startling 46.3% of EITC recipients obtain either a RAL or a RAC; in other words, about half of EITC recipients pay part of their publicly funded benefits to a bank to obtain a tax-related financial product. In contrast, only about 7% of taxpayers who do not receive the EITC get a RAL or RAC.<sup>51</sup>

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<sup>42</sup> *Watts v. Jackson Hewitt Tax Service*, 579 F. Supp.2d 334 (E.D.N.Y. 2008).

<sup>43</sup> Government Accountability Office, *Paid Tax Return 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>. [hereinafter “GAO 2006 Preparer Testing Report”].

<sup>44</sup> NCLC/CFA 2006 RAL Report at 15.

<sup>45</sup> Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>46</sup> See NCLC/CFA 2007 RAL Report at 11.

<sup>47</sup> NCLC/CFA 2006 RAL Report at 12.

<sup>48</sup> IRS data reports that 6.4 million EITC returns were associated with a RAL in 2006. Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009. Using the 85% approval rate, see Section I.A *supra*, the number of approved RALs is 5.44 million.

<sup>49</sup> There were 22 million EITC returns in 2006 and 134 million individual tax returns in 2006. Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>50</sup> *Id.*

<sup>51</sup> Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, *Do Products Offering Expedited Refunds Increase Income Tax Non-Compliance*, Office of Research, Analysis and Statistics, Internal Revenue Service, 2008, at 3, on file with authors.

Based on this IRS data, we estimate that about \$523 million was drained out of the EITC program in 2007 by RAL loan fees.<sup>52</sup> Add-on fees added another \$44 million to the drain.<sup>53</sup>

Non-loan fees also drain significantly from 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 both the drain created by RALs and by tax preparation fees. Including tax preparation provides a fuller picture of how EITC benefits are chipped away. EITC recipients who got RALs paid an additional \$996 million in tax preparation fees. In addition, some percentage of these recipients paid check cashing fees.

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee (inc. dummy account fee)	\$58 or \$107.50	\$523 million
Add-on Fee (for 20%)	\$40	\$44 million
<b>Total</b>	<b>\$98 or \$147.50</b>	<b>\$567 million</b>
Tax preparation fee	\$183	\$996 million
<b>Total with tax preparation</b>	<b>\$281 or \$330.50</b>	<b>\$1.56 billion</b>

#### D. Risks of RALs

In addition to their costs, RALs present significant risks to their borrowers. Thus, even with lower costs, taxpayers are advised to avoid RALs to prevent these problems.

A RAL must be repaid even if the taxpayer's refund is denied, is smaller than expected, or is frozen. If the taxpayer cannot pay back the RAL, the lender may send the account to a debt collector. In some cases, the unpaid RAL will show up as a black mark on the taxpayer's credit record.

There has been another significant risk if the IRS denies or reduces a taxpayer's refund, leaving her with unpaid RAL debt – the practice of cross-lender debt collection of prior year's unpaid RALs. If the taxpayer with unpaid RAL debt applies for a RAL or RAC from a commercial preparer in any subsequent year, she may find that her subsequent year's refund gets seized to repay the prior unpaid RAL debt.

Cross-lender debt collection has been explained in detail in prior NCLC/CFA RAL Reports.<sup>54</sup> It has been the subject of several lawsuits, including one in which NCLC is co-counsel. This lawsuit resulted in a settlement in which SBBT agreed to cease cross-collection for 2009. In addition, in future years, SBBT will provide notices informing

<sup>52</sup> Most RAL borrowers paid an average loan fee of \$107.50 for the average refund of \$2,700. About 23% of the market who obtained Block Emerald Card paid \$58. Thus the total is \$523 million (4.19 million times \$107.50) plus (1.25 million times \$58).

<sup>53</sup> Weighted to 20%, see Section I.A, *supra*.

<sup>54</sup> NCLC/CFA 2007 RAL Report at 16-17; NCLC/CFA 2004 RAL Report at 19-20; NCLC/CFA 2002 RAL Report at 24.

consumers before they apply for RALs, if they have an outstanding RAL debt which will result in cross-collection.<sup>55</sup> JPMorgan Chase informs us it no longer engages in cross-collection. HSBC has stated in its SEC filings that it will no longer engage in cross-collection as well.<sup>56</sup>

#### E. RACs and Bank Accounts

Refund anticipation checks (RACs) are a non-loan payment device offered by RAL banks. 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 paper check or prepaid debit card with the RAC proceeds and closes the temporary account.

RACs generally cost around \$30. In the past 2 years, the IRS has separately reported RAC data. In 2007, nearly 11.2 million taxpayers received a RAC,<sup>57</sup> at a cost of about \$336 million.

Thus, the number of RACs sold to consumers actually exceeds the number of RALs. RACs present different issues than RALs. They are less expensive than a RAL, although they are still very pricey for what is essentially a one-time use bank account. Consumers with a bank account can receive their refunds in the same amount of time but avoid paying a fee for a RAC, if they simply use e-file and a direct deposit to their own bank accounts.

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 to access funds from a RAC. Greater bank account usage may also help reduce the number of RALs. A study of low and moderate income residents found that taxpayers without bank accounts were twice as likely to take out RALs as taxpayers who had bank accounts.<sup>58</sup>

There are other options for receiving fast refunds for taxpayers without bank accounts. H&R Block customers who received the Emerald Card last year could have this year's refunds direct deposited onto those cards, and avoid the fee for a RAC

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<sup>55</sup> Preliminary Approval of Class Settlement, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara Jan. 7, 2009), available at [http://www.consumerlaw.org/issues/cocounseling/content/hood\\_Order-After-Hearing-Prelim-Approval.pdf](http://www.consumerlaw.org/issues/cocounseling/content/hood_Order-After-Hearing-Prelim-Approval.pdf).

<sup>56</sup> HSBC Finance Corp., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 13 [hereinafter "HSBC 2007 Form 10-K"].

<sup>57</sup> Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>58</sup> Michael S. Barr and Jane K. Dokko, *Tax Filing Experiences and Withholding Preferences of Low- and Moderate-Income Households: Preliminary Evidence from a New Survey*, in Proceedings of the IRS Annual Research Conference. Washington, DC: IRS, 2006, at 200, available at <http://www.irs.gov/pub/irs-soi/06barr.pdf>.

altogether. There are similar prepaid debit cards available to taxpayers who use free tax preparation sites.

However, none of the above alternatives achieves another purpose of RACs – the ability to avoid paying tax preparation fees up front. If the consumer simply has her refund direct deposited into her own bank account, the consumer must pay preparation fees out-of-pocket. Thus, RACs may in some cases be disguised loans to pay preparation fees. If the RAC fee were to be treated as a finance charge for the loan of a tax preparation fee, based on a typical fee of \$183, the APR for this loan would be nearly 600%.

In addition to the RAC fee itself, many tax preparers who charge add-on fees, such as “document processing” or e-filing, for RALs will charge these fees for RACs as well. This can significantly add to the expense of a RAC.

#### F. RALs Enable Preparers to Obfuscate the Price of Tax Preparation

The ability to deduct tax preparation fees from a RAC – or a RAL – points to another problem with these products. RALs and RACs enable commercial preparers to withhold information on the price of tax preparation. They also make taxpayers less sensitive to the price of preparation.

Mystery shopper testing by consumer groups and government agencies has found multiple examples of preparers refusing to provide testers with a quote for the tax preparation fee. At least three testers in mystery shopper testing conducted in Philadelphia and Durham, NC in 2008 reported that commercial preparers refused to give them a quote on preparation services.<sup>59</sup> Another advocacy group, Impact Alabama, noted that its mystery shopper testing found that “[m]ost of the preparers did not give the testers price estimates for preparation ahead of time. Most commercial tax preparers base their pricing by form, and thus claim they cannot provide an estimate before preparation begins. This failure to provide clear pricing makes comparison shopping difficult.”<sup>60</sup> In addition, the head of this group noted in press statements that “[a]t the end many [preparers] pull out a number and clearly charge more the bigger the refund is...”<sup>61</sup>

Testing by the GAO in 2006 found that 8 out of 19 preparers either did not provide an estimate or gave an estimate with the qualifier that the fee would depend on the forms required. Furthermore, the GAO found: “The fees charged in our 19 visits varied widely, sometimes between offices affiliated with the same chain, and were sometimes significantly larger or smaller than the original estimate we were given.”<sup>62</sup>

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<sup>59</sup> Durham/Philadelphia Mystery Shopper Report at 9.

<sup>60</sup> Impact Alabama, *Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis*, Jan. 2009, on file with authors.

<sup>61</sup> Nick Cenegy, *Group Finds Errors in Alabama Tax Returns Probe; Aniston Business Named in Study*, *Anniston Star*, Jan. 23, 2009.

<sup>62</sup> GAO 2006 Preparer Testing Report at 24.

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 RAL or RAC, consumers may not be as sensitive to this lack of pricing information.

The ability to deduct fees from a RAL or RAC also enables independent preparers to pad the price with add-on fees. As a trade newsletter published by a software provider for independent preparers bluntly advised:<sup>63</sup>

The most successful e-file shops in the U.S. do not use price lists and they "lowball" their tax preparation charges to get the customer in the door. (Note: In some markets it's customary to throw in free e-file and charge a higher price for the tax return preparation). ***They then charge more for e-filing and bank products to make up for the "lowball" price.*** For instance, if the going price for 1040EZ's in your area is \$49 you might want to charge \$29. Advertise the \$29 price with a note at the bottom (the fine print) that says "1040EZ's". Get the customer in the door. Then charge more for the e-file and bank products to make up for the discounted \$29 price. (emphasis added).

An example of this type of "successful" tax preparer was a Jackson Hewitt franchisee with more than a dozen offices in New York and New Jersey. This Hewitt franchisee allegedly advertised that its minimum fees were \$27 for a New York State long form and \$22 for a New York State short form. However, the franchisee would automatically add various extra fees, including a 15% multiplier to its tax preparation fee and a \$25 hidden RAL/RAC fee. One customer was charged \$50 in hidden RAL/RAC fees, a \$75 RAL application fee, \$57 for the Form 1040, \$27 for a NYS Long form, \$72 for a Child Care Credit form, and \$6 for unemployment compensation – on top of the RAL fee of \$150. However, the customer was never given this itemized breakdown of fees.<sup>64</sup>

In fact, the ability to obfuscate pricing is so lucrative that some Jackson Hewitt franchisees filed a lawsuit when the parent corporation stopped permitting them to charge add-on fees. They alleged that the corporation's decision to prohibit them from gouging consumers for these extra add-on fees was unconscionable, void for economic duress, and was unjust enrichment!<sup>65</sup>

These franchisees freely admitted that the ability to obfuscate pricing by adding add-on fees gives tax preparers an advantage, stating:

If franchisees, such as Plaintiffs, attempt to compensate for the lost income resulting from the prohibition on charging application fees for Bank Products by raising the price of other services, such as tax preparation fees, they will be at a competitive

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<sup>63</sup> WorldWideWeb Tax, *Tax Return Pricing*, The Tax Time News, Oct. 2008, on file with authors.

<sup>64</sup> *Watts v. Jackson Hewitt Tax Service*, 579 F. Supp.2d 334 (E.D.N.Y. 2008).

<sup>65</sup> Complaint, *Big Sky Ventures I, LLC v. Pacific Capital Bancorp., N.A.*, Civ. 08-00231 (C.D. Cal. Jan. 14, 2008).



disadvantage compared to tax preparation services that advertise lower tax preparation fees, but are permitted to charge additional fees for Bank Products.<sup>66</sup>

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<sup>66</sup> *Id.*

## PART II. UPDATES AND ANALYSIS

In this section, we discuss some of the most significant developments with respect to RALs in 2008.

### A. Return of the Pay Stub RAL

Last year, we reported the demise of “pay stub” and “holiday” RALs.<sup>67</sup> These were RALs made prior to the tax filing season, before taxpayers received their IRS Form W-2s and could file their returns. Unfortunately, this demise was short-lived. Both H&R Block and Jackson Hewitt are promoting loans made before the tax season based on anticipated refunds.

Jackson Hewitt’s version is called the ipower Line of Credit, up to \$500, issued by MetaBank. MetaBank charges a 1.5% fee for the first advance from the line, and a 10% charge per advance thereafter, plus 18% periodic interest.<sup>68</sup> A taxpayer who borrows the entire \$500 in the first advance would be charged a \$57.65 fee. If the ipower loan is repaid in one month, the total fee would be \$65.15. A one month, closed-end loan with the same loan amount and fee would have an APR of 177%.

H&R Block’s version uses its Emerald Advance Line of Credit. This is a line of credit that Block had offered previously to its Emerald Card customers, and is available for some customers on a year-round basis, for up to \$1,000.<sup>69</sup> This year, however, Block explicitly promoted the Emerald Advance as a tax-related pre-season loan and made it available to new customers. The Emerald Line of Credit carries an interest rate of 36% plus an annual fee of \$45.<sup>70</sup> For a \$500 advance repaid in one month, the total fee is \$60. A one month, closed-end loan with the same loan amount and fee would have an APR of 158%, if the annual fee were to be included in the finance charge (which Truth in Lending does not require). If the borrower keeps the line open after tax season, the interest rate is lowered to 9%, but requires either payroll direct deposit to Block’s Emerald Card or a savings account linked to the card.<sup>71</sup> Block sold 887,000 Emerald Advances in 2008.<sup>72</sup>

RALs based on pay stubs present risks to taxpayers, because they are based on estimated tax returns before the taxpayer receives final tax information from a W-2. For example, before filing the tax return, the preparer will not have any information about whether the IRS is planning to seize all or part of the taxpayer’s refund to pay a child

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<sup>67</sup> NCLC/CFA 2008 RAL Report at 18-19.

<sup>68</sup> Metabank, ipower® Plus Line of Credit Terms and Conditions, 2008, on file with authors.

<sup>69</sup> H&R Block, Emerald Advance Overview, Jan. 14, 2009, at 3, on file with authors.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*; H&R Block, Inc. F2Q09 (Qtr End 10/31/08) Earnings Call Transcript, Dec. 8, 2008, from Seeking Alpha at <http://seekingalpha.com/article/109760-h-and-r-block-inc-f2q09-qtr-end-10-31-08-earnings-call-transcript>.

<sup>72</sup> *Id.*

support or student loan debt. H&R Block does state that it conducts underwriting for its loans based on considerations other than the estimated refunds.<sup>73</sup>

In addition, Jackson Hewitt in the past appeared to force pay stub RAL borrowers to return to the same office to have their taxes prepared, preventing these taxpayers from going to competitors or seeking free volunteer assistance.<sup>74</sup> The MetaBank agreement appears to assume the taxpayer will return to Jackson Hewitt for tax preparation and requires the borrower to have her RAL, RAC or tax refund loaded onto the ipower card.<sup>75</sup> In addition, Jackson Hewitt may be charging a \$25 or \$35 “tax planning fee” for iPower loans.<sup>76</sup> Block does not require Emerald Advance customers to return to Block for tax preparation, but 91% of them do return.<sup>77</sup>

NCLC and CFA issued a report on pay stub and holiday RALs in November 2006, entitled *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom*.<sup>78</sup>

## B. New Studies on RALs

In 2008, several significant studies on RALs were released by consumer groups and government investigators.

### 1. *Durham, NC and Philadelphia, PA Mystery Shopper Tests*<sup>79</sup>

The Community Reinvestment Association of North Carolina (CRA-NC) in Durham and Community Legal Services of Philadelphia (CLS) and the Philadelphia Campaign for Working Families conducted 17 “mystery shopper” tests of paid tax preparers. The National Consumer Law Center (NCLC) analyzed test results for the report.

The tests were conducted at H&R Block, Jackson Hewitt, Liberty Tax service and independent preparers. The results reveal an industry that varies tremendously in terms of providing consumers with information about refund anticipation loans (RALs), and in its overall quality of services.

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<sup>73</sup> H&R Block, Emerald Advance Overview, Jan. 14, 2009, at 3, on file with authors.

<sup>74</sup> Chi Chi Wu, *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom*, National Consumer Law Center (Nov. 2006), at 7-8.

<sup>75</sup> Metabank, ipower® Plus Line of Credit Terms and Conditions, 2008, on file with authors.

<sup>76</sup> Email from David Rothstein, Policy Matters Ohio, Jan. 13, 2009 (notes of Policy Matters Ohio intern who visited H&R Block and Jackson Hewitt offices for pay stub RALs). See also Paul Donsky and Kirsten Tagami, *Demand Grows for Tax Refund Loans*, Atlanta Journal Constitution, Jan. 7, 2009 (consumer paid \$66 for a ipower Advance of \$234, which must have included another fee because loan fee should have been only \$34.50).

<sup>77</sup> H&R Block, Inc. F2Q09 (Qtr End 10/31/08) Earnings Call Transcript, Dec. 8, 2008, from Seeking Alpha at <http://seekingalpha.com/article/109760-h-amp-r-block-inc-f2q09-qtr-end-10-31-08-earnings-call-transcript>.

<sup>78</sup> Available at [www.consumerlaw.org/action\\_agenda/refund\\_anticipation/content/PaystubRALsReport.pdf](http://www.consumerlaw.org/action_agenda/refund_anticipation/content/PaystubRALsReport.pdf).

<sup>79</sup> Durham/Philadelphia Mystery Shopper Report.

All of the testers had their taxes prepared by commercial preparers. Fifteen of these testers received RALs or a refund anticipation check (RAC). (One of these testers had to withdraw because of incompetent tax preparation, and another tester was not given a RAL or RAC).

The test results showed that some preparers still do not inform taxpayers that a RAL is a loan, despite years of complaints and lawsuits on that issue. Three preparers in Durham and two in Philadelphia did not explain to testers that a RAL is a loan. Two other preparers in Philadelphia made this disclosure only after being questioned by testers.

Even when testers were told that a RAL is a loan, they were confused because many preparers did not give clear price information about RALs, other bank product options, and tax preparation fees. Only one preparer in either city informed the tester of the option to receive a fast, free refund by e-file and direct deposit.

Five testers were given RALs or other bank products by default. One tester was only given a RAL as an option; one was only given the option of a RAL or other bank product; and at least three others were automatically required to pay charges for bank products for state refunds.

One of the most disturbing test results involved the quality of tax preparation. Several preparers made serious errors that significantly affected tax liability. Two testers were required to file amended returns to fix errors. One tester withdrew after the preparer advised him not to include investment income on a return, essentially recommending tax fraud. This tester told coordinators “My experience with [the independent preparer] has been a scary one. I say that mainly because of the lack of confidence in the preparer’s ability to competently complete our return ....”

Results varied for independent preparers. Several of these preparers, including a gift shop and a small loan company, charged multiple add-on fees, including one preparer who charged \$324 in such fees. However, another independent preparer steered both testers who went to her office away from RALs.

A copy of the report, *Tax Preparers Take a Bite out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*, is available at [http://www.nclc.org/issues/refund\\_anticipation/content/shopper\\_report.pdf](http://www.nclc.org/issues/refund_anticipation/content/shopper_report.pdf).

## 2. *Impact Alabama Mystery Shopper Tests*<sup>80</sup>

Impact Alabama conducted mystery shopper tests of 13 tax preparers. Testers described themselves to preparers as parents with one or two children who lived with them less than six months of the year, which would not make them eligible for the EITC. Impact Alabama found that 11 of the 13 preparers incorrectly claimed the EITC. In

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<sup>80</sup> Impact Alabama, *Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis*, Jan. 2009, on file with authors.

addition, ten preparers did not report income from other jobs such as babysitting, nine preparers did not report interest income, and eleven allowed testers to claim “head of household” status without being qualified for it.

All of the testers should not have qualified for refunds, but each preparer figured a refund ranging from \$65 to \$6,247. Five preparers figured a refund of \$6,247 for a taxpayer who actually owed \$112 to the IRS. These five preparers included a fringe preparer, Columbus Finance Company, a “Mo’ Money Taxes” outlet, and three other independent preparers.

Impact Alabama reported that the cost of tax preparation ranged from \$80 to \$402. It noted that most preparers did not give the testers price estimates for preparation ahead of time. Impact Alabama also reported that preparers promoted RALs to the testers.<sup>81</sup>

### 3. *Treasury Inspector General for Tax Administration RAL Report*<sup>82</sup>

TIGTA conducted a telephone survey of 350 taxpayers whose IRS tax records indicated that they had received a RAL. Of these, 250 respondents indicated that they had received RALs. TIGTA concluded that most of these 250 respondents (85%) understood that they had received a loan. However, given that these respondents were the ones who stated they had received a “refund anticipation loan,” one would expect they would know that they had received a “loan.” Note that there were 100 respondents who stated they did not obtain a RAL despite what the IRS’ records indicated. While some of these respondents may have been denied a RAL and received a RAC, others may have received a RAL without knowing it was a loan and thus answered negatively to the question of whether they had received a RAL.

For the 250 who responded that they received RALs, the TIGTA survey found:

- 213 (85%) stated that preparers made it clear they were receiving loans. In addition, 220 (88%) stated that the preparers explained the fees. However, only 85 respondents (34%) stated that they were provided the interest rate for the RALs.
- Only about half (131 or 52%) received their RALs the same day or within 2 business days.
- The average fees by paid by respondents with refunds under \$2,000 was \$183, including tax preparation, loan fees, and add-on fees. Respondents with refunds of \$2000 to \$3000 paid an average of \$280 in fees, while respondents with refunds of \$3000 to \$4000 paid an average of \$300.
- 210 (84%) had income of less then \$40,000.

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<sup>81</sup> Steve Doyle, *Group Uncovers Tax Cheaters*, Huntsville Times, Jan. 23, 2009.

<sup>82</sup> Treasury Inspector General for Tax Administration, *Many Taxpayers Who Obtain Refund Anticipation Loans Could Benefit from Free Tax Preparation Services*, Reference Number: 2008-40-170, Sept. 8, 2008, available at <http://www.ustreas.gov/tigta/auditreports/2008reports/200840170fr.pdf>.

- 158 (63%) received the EITC. Tax return preparation and RAL fees consumed from 10 to 39 % of these taxpayers' EITC benefits, with the percentage generally higher for low-income taxpayers.
- More than half (159 or 64%) held checking or savings accounts.
- 167 (67%) stated that preparers explained how long it would take for the taxpayers to receive their tax refunds if they chose not to obtain a RAL. However, the survey was unclear as to whether preparers explained that taxpayers could receive their refunds in 8 to 15 days without a RAL, or even faster in some cases.
- 213 (85%) stated they obtained RALs because they wanted faster access to their tax refunds, and 185 (74%) used the money to pay bills. Another 14 (6%) used the money to buy or repair a car or for home repairs and expenses. Eight percent stated that they put the money in savings. It seems illogical for a taxpayer to pay a steep fee to receive funds quicker, then turn around and deposit the funds in a savings account.

Most importantly, TIGTA found that 212 (85%) of respondents said they would have been willing to wait up to nine days to receive their tax refund directly from IRS, which would have avoided the loan fees. TIGTA's analysis of IRS data found that the average time for an e-file, direct deposit refund was 10 days.

The TIGTA report also discussed the new IRS computer system that is expected to reduce the amount of time required to issue tax refunds, which should reduce the appeal of RALs. It appears some progress is being made with this new system, because tax returns for 45 (18%) of the 250 respondents were processed using it.

Finally, TIGTA noted that the majority of respondents would have qualified for the IRS' free tax return preparation assistance. However, 81% (284 of 350) stated that they were unaware of these free services. TIGTA recommended that the IRS take a more aggressive approach to educate the taxpaying public about their free options.

### 3. *TIGTA Preparer Testing Report*<sup>83</sup>

TIGTA conducted a second study in 2008 focused on the accuracy of returns prepared by paid preparers. TIGTA auditors tested 28 preparers (12 commercial chains and 16 independent preparers). The TIGTA study found that only 11 (39 percent) of the 28 storefronts prepared an accurate tax returns. The other 17 preparers (61 percent) prepared the returns incorrectly.

- 11 (65 percent) of the 17 contained mistakes and omissions that TIGTA considered to have been caused by human error and/or misinterpretation of the tax laws.

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<sup>83</sup> Treasury Inspector General for Tax Administration, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*, Reference Number: 2008-40-171, Sept. 3, 2008, available at <http://www.ustreas.gov/tigta/auditreports/2008reports/200840171fr.pdf>.

- 6 (35 percent) of the 17 contained misstatements and omissions TIGTA considered to have been willful or reckless.

One of the six preparers who committed a willful or reckless error claimed a charitable deduction on the return, even after the auditor posing as a taxpayer said he had made no charitable contributions that year. That same preparer also added a property-tax deduction for a car -- even though the taxpayer didn't say anything or offer any documentation verifying he was eligible for that deduction. Another preparer falsely increased the amount that an auditor reported for child care expenses.

Altogether, these errors and misstatements would have cost \$12,828 to the U.S. Treasury in understated taxes.

#### 4. *Government Accountability Office Report*<sup>84</sup>

In June 2008, the GAO released a report based on its mystery shopper testing of tax preparers in the several states. The investigation was limited to identifying types of businesses where RALs are marketed, and what information preparers disclosed to RAL applicants.

Of the 40 tax preparers the GAO called or visited, 37 offered RALs. Thirteen tax preparers offered year-round tax preparation in their own stand-alone offices, while 27 were open only during the tax season and operated at tables or desks within existing businesses offering other products and services. Of these 27 preparers, 13 were located in businesses that target low-income customers, such as check cashers, payday loan vendors, rent-to-own stores, and pawn shops.

Nine of these preparers offered incentives to encourage tax customers to spend their refunds on the businesses' primary goods and services. For example, an auto dealer told GAO investigators that if they didn't have enough money for the down payment on a car, they could get their taxes done by its tax preparer and use the refund as a down payment. Another preparer operated out of a shoe store, and offered a free pair of shoes with tax preparation.

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<sup>84</sup> Government Accountability Office, *Refund Anticipation Loans*, GAO-08-800R, June 5, 2008, available at <http://www.gao.gov/new.items/d08800r.pdf>.

From the GAO's report

Figure 4: Shoe Store Offering a Free Pair of Shoes with Tax Preparation



Source: GAO.

Other businesses visited or called by the GAO included:

- A tax preparer operating out of a trailer in the parking lot of a gas station.
- Payday lender Check-Into-Cash
- A van rental store
- A vending service company
- An immigrant services business

#### C. IRS Rulemaking Proceeding Concerning RALs

In January 2008, the IRS issued a request for comments regarding whether it should develop rules restricting the sharing of tax return information to market RALs, RACs, audit insurance and other financial products typically sold to low-income taxpayers.<sup>85</sup> The IRS specifically asked for information about whether these products provide preparers with a financial incentive to inflate refund claims inappropriately.

In response, NCLC, CFA and other consumer groups sent in extensive evidence that RALs do provide an incentive for preparers to inflate refunds, and that they make it easier for criminals to commit tax fraud.<sup>86</sup> In addition, RALs entice a particularly troubling type of tax preparer – the fringe preparer. Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers, as well as retailers and businesses that target immigrant communities. The evidence that NCLC, CFA and other consumer groups submitted to IRS regarding the role RALs in promoting tax fraud and fringe preparers is included in Appendix A, which is a report on the role of RALs in promoting tax fraud and fringe preparers.

<sup>85</sup> 73 Fed. Reg. 1131 (Jan. 7, 2008).

<sup>86</sup> NCLC/CFA Comments to IRS RAL ANPR.



On the other side, H&R Block sent an email to potentially millions of its customers urging them to oppose the IRS proposal. The email warned that the proposal would mean that taxpayers “would no longer control the use or disclosure of your personal information through your tax preparer, even if you wish to do so.”<sup>87</sup> The email framed the proposal as a threatening scheme by the IRS, which may have been part of the reason it generated several thousand comments opposing the proposal.

After the comment period closed, IRS conducted its own study of RAL returns. IRS researchers examined different sets of tax returns that had been audited, some with RALs or RACs and others without. They found that “propensity scoring methods indicate that there is a significant correlation between taxpayers who use RALs and noncompliance. RAL users are 27 percent - 36 percent more noncompliant than taxpayers who do not use a bank product.”<sup>88</sup> The researchers cautioned that the higher rates of noncompliance by RAL users does not prove that RALs cause tax fraud.

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<sup>87</sup> *Id.* at Appendix H.

<sup>88</sup> Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, *Do Products Offering Expedited Refunds Increase Income Tax Non-Compliance*, Office of Research, Analysis and Statistics, Internal Revenue Service, 2008, at 15, on file with authors..

### PART III. INDUSTRY PLAYERS

This section provides basic information on the RAL activity of key industry players, an overview that we provide annually in our RAL reports. We discuss certain other topics affecting these players, such as law enforcement actions, reform measures by certain companies, and other events, in other parts of this report.

The RAL industry is made up of a handful of RAL lending banks, three commercial preparation chains, and thousands of independent preparers that offer and arrange for RALs. The loans are made by banks because of the banks' ability to avoid state interest rate caps and because IRS rules prohibit the tax preparer from being the RAL lender.<sup>89</sup>

#### A. H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 16% of all individual tax returns in 2007.<sup>90</sup> In 2007, Block's RAL business remained steady at 3.85 million RALs,<sup>91</sup> compared to 4 million in 2006.<sup>92</sup> Block processed 15.7 million tax returns (excluding software/online processed returns) in 2007;<sup>93</sup> thus, about 25% of customers who went to a Block office received RALs that year. Block's RAL business essentially remained the same in 2008, at 3.9 million<sup>94</sup>

Block earns fees from RALs through its arrangement to have Block Financial Corporation buy a 49.9% interest in RALs arranged by its tax preparation offices. In 2007, Block earned \$192 million in revenues from RALs, plus \$17.6 million from its participation share in pay stub RALs, representing about 8% of the company's revenues from tax services.<sup>95</sup> In 2008, Block's RAL profits dipped to \$190 million, but the dip was apparently offset by \$24.1 million in revenues from the Emerald Advance product.<sup>96</sup> This constituted 7% of tax services revenue.<sup>97</sup>

Over the years, Block has instituted a number of reforms in its RAL and financial product offerings. In 2007, it introduced the Emerald Card, a low cost bank account based on a prepaid debit card platform. The Emerald Card has the distinction of being one of the few bank accounts that does not permit consumers to overdraw their accounts

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<sup>89</sup> See NCLC/CFA 2002 RAL Report at 18-19.

<sup>90</sup> H&R Block Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 6. [hereinafter "H&R Block 2007 Form 10-K"].

<sup>91</sup> *Id.* at 26.

<sup>92</sup> H&R Block Inc., *2006 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 25.

<sup>93</sup> H&R Block 2007 Form 10-K at 26.

<sup>94</sup> H&R Block Inc., *2008 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 24. [hereinafter "H&R Block 2008 Form 10-K"].

<sup>95</sup> H&R Block 2007 Form 10-K at 6, 26.

<sup>96</sup> H&R Block 2008 Form 10-K at 25

<sup>97</sup> *Id.*

using a debit card – a practice NCLC, CFA, and other consumer groups have heavily criticized. Block sold 2 million Emerald Cards in 2007 and 2.6 million in 2008.<sup>98</sup>

In addition, Block took the lead in lowering RAL prices, with JPMorgan Chase following suit. In 2008, H&R Block offered true 36% APR RALs to Service members at 137 outlets located near major military bases. Unfortunately, Block terminated this military RAL as a “result of not being able to reach an agreement with our RAL lending partner,”<sup>99</sup> *i.e.*, HSBC. Note that this military RAL was *not* terminated because of lack of profitability.

On the other hand, Block has participated in the return of pre-season or “pay stub” RAL products. It offers the Emerald Advance, which provides loans of up to \$1,000 as early as the November prior to tax season. The Emerald Advance is discussed above in Section II.A.

## B. HSBC

HSBC is the RAL lender for H&R Block. In addition, HSBC previously had made RALs through independent preparers. Last year, HSBC decided to stop making RALs through independent preparers, and only work with Block, Jackson Hewitt and one other channel.<sup>100</sup> This year, HSBC is only working with Block.<sup>101</sup> It has also stopped participating in cross-collection.<sup>102</sup>

HSBC reported that in 2007, it had over 11 million refund product customers and had worked with tax preparers in 36,000 offices.<sup>103</sup> HSBC’s RAL/RAC income was \$247 million in 2007, representing a 4% decrease from its income of \$258 million in 2006.<sup>104</sup> HSBC originated \$17.4 billion in RALs in 2007.<sup>105</sup> However, it expects that RAL and RAC revenue could decrease by up to \$110 million because it has stopped making RALs and RACs through independent preparers.<sup>106</sup>

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<sup>98</sup> H&R Block, Inc. F2Q09 (Qtr End 10/31/08) Earnings Call Transcript, Dec. 8, 2008, from Seeking Alpha at <http://seekingalpha.com/article/109760-h-amp-r-block-inc-f2q09-qtr-end-10-31-08-earnings-call-transcript>.

<sup>99</sup> H&R Block, Information about the Military RAL, undated, available at [http://www.hrblock.com/popups/pop\\_military\\_ral.html](http://www.hrblock.com/popups/pop_military_ral.html).

<sup>100</sup> Antoinette Alexander, *The Check Is In ... The Bank*, Accounting Technology, Nov. 1, 2007.

<sup>101</sup> HSBC Finance Corp., *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, 2008*, at 38.

<sup>102</sup> HSBC Finance Corp., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 13.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 59.

<sup>105</sup> *Id.* at 13.

<sup>106</sup> *Id.*

### C. Jackson Hewitt

Jackson Hewitt is the second largest tax preparation chain in the country, preparing 3.65 million returns in 2007, or about a 4% share of the paid preparer market.<sup>107</sup> Its main bank partner for RALs and other tax financial products is Santa Barbara Bank and Trust (SBBT), which provides 65% of Hewitt's RALs.<sup>108</sup> Jackson Hewitt also has a partnership with Republic Bank & Trust of Kentucky.<sup>109</sup>

In 2007, Jackson Hewitt sold one or more financial product to 3.4 million (or 93%) of its customers.<sup>110</sup> It no longer breaks out the number of RALs it makes in its SEC filings. However, we had estimated that Jackson Hewitt brokered about 1.3 to 1.4 million RALs in 2006. Given its flat growth in 2007, we assumed Hewitt made a similar number of loans in 2007.

In 2008, Jackson Hewitt's numbers declined by about 7 or 8%. The company processed 3.4 million tax returns<sup>111</sup> and about 3.1 million (or 91%) of these taxpayers were sold a financial product.<sup>112</sup> We assume that the number of RALs declined slightly as well, to 1.2 to 1.3 million RALs.

Jackson Hewitt continues to derive a startling percentage of its profits from financial products. It earned \$80 million in financial product fees in 2007, about 27% of its total revenues.<sup>113</sup> In 2008, Hewitt earned \$71 million in financial product fees, or 26% of its revenues.<sup>114</sup> Thus, Jackson Hewitt is much more dependent than Block on RALs and other tax financial products.

Jackson Hewitt's decline in overall tax returns as well as financial products sold could be the fallout of the U.S. Department of Justice's lawsuit against five of its franchisees in April 2007. DOJ sued these franchisees, which operated 125 Hewitt offices, for their role in preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. As a result of these lawsuits, Hewitt was required to charge off \$8.3 million in losses, and paid a \$1.5 million fine to the IRS.<sup>115</sup>

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<sup>107</sup> Jackson Hewitt Tax Service Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 2 [hereinafter "Jackson Hewitt 2007 Form 10-K"].

<sup>108</sup> *Pacific Capital Bancorp Conference Call*, Financial Disclosure Wire, Nov. 1, 2007.

<sup>109</sup> See <http://www.jacksonhewitt.com/ProductsRefund>, visited February 11, 2009.

<sup>110</sup> Jackson Hewitt 2007 Form 10-K at 28. This includes RALs, RACs and Hewitt's "Gold Guarantee."

<sup>111</sup> Jackson Hewitt Tax Service Inc., *2008 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 30 [hereinafter "Jackson Hewitt 2008 Form 10-K"].

<sup>112</sup> *Id.* at 29.

<sup>113</sup> Jackson Hewitt 2007 Form 10-K at 3, 27.

<sup>114</sup> Jackson Hewitt 2008 Form 10-K at 3, 28.

<sup>115</sup> *Jackson Hewitt Quarterly Loss Widens*, Reuters, Nov. 27, 2007.

Jackson Hewitt has stated that it believes its business declined in 2008 because it did not offer a pay stub RAL.<sup>116</sup> This year, Jackson Hewitt returned with a pre-season or pay stub RAL – the ipower Line of Credit, discussed in Section II.A above.

D. Santa Barbara Bank & Trust/Pacific Capital Bancorp

Jackson Hewitt's main RAL partner is Santa Barbara Bank & Trust (SBBT), a subsidiary of Pacific Capital Bancorp. In 2007, SBBT made 1.83 million RALs.<sup>117</sup> SBBT earned \$118 million in RAL fees in 2007, \$42 million on the gain on sale of RALs via securitization, and \$46 million in refund anticipation check fees.<sup>118</sup>

In 2007, SBBT suffered large loan losses due to fraud by tax preparers and clients, including fraud that was the subject of the U.S. Department of Justice lawsuit. The bank was required to charge-off \$62.7 million in RAL losses in the first quarter of 2007, an increase of 53.6% from 2006.<sup>119</sup> The bank's loan loss rate on RALs increased from 1.25% to 2% in 2007.<sup>120</sup> The bank was forced to set aside \$6 million because of the DOJ lawsuit and eventually took a \$22 million hit in unpaid RALs due to fraud.<sup>121</sup> Part of the increase in fraud losses was caused by pay stub and holiday RALs.<sup>122</sup>

In 2008, SBBT implemented new "risk management controls" that resulted in a higher percentage of RAL applications being rejected, which automatically converted them to a RAC.<sup>123</sup> This shifted the mix from 69% RAC/31% RAL to 73% RAC/ 27% RAL.<sup>124</sup>

SBBT also saw its RAL and RAC volume rise by 27%, probably as a result of HSBC's decision to cease offering RALs through most independent preparers.<sup>125</sup> Between these two phenomena, SBBT's volume of RALs and RACs increased by 1.5 million from 2007 to 2008 to 6.3 million.<sup>126</sup> Thus, we estimate SBBT made about 2.3 million RALs in 2008.

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<sup>116</sup> Jackson Hewitt Tax Service Inc. F4Q08 (Qtr End 04/30/08) Earnings Call Transcript, June 5, 2008, from Seeking Alpha at <http://seekingalpha.com/article/80231-jackson-hewitt-tax-service-inc-f4q08-qtr-end-04-30-08-earnings-call-transcript>

<sup>117</sup> Pacific Capital Bancorp Conference Call, *Financial Disclosure Wire*, Nov. 1, 2007.

<sup>118</sup> Pacific Capital Bancorp, *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 27, 100. [hereinafter "PCB 2007 Form 10-K"]

<sup>119</sup> Katie Kuehner-Hebert, *In Brief: Pacific Capital Cites Tax Loan Problems*, *American Banker*, Apr. 25, 2007.

<sup>120</sup> *Pacific Capital Bancorp Conference Call*, *Financial Disclosure Wire*, October 29, 2007.

<sup>121</sup> Press Release, *Pacific Capital Bancorp Provides Update on Performance of 2007 Refund Anticipation Loan and Refund Transfer Programs*, October 29, 2007.

<sup>122</sup> *Pacific Capital Bancorp Conference Call*, *Financial Disclosure Wire*, October 29, 2007 (stating that two-thirds of the increase in loan loss rates was due to pay stub and holiday RALs).

<sup>123</sup> Pacific Capital 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 June 30, 2008*, at 18. [hereinafter "PCB June 2008 Form 10-Q"]

<sup>124</sup> Pacific Capital Bancorp (PCBC), Transcript of Q1 2008 Earnings Call, May 19, 2008, from Seeking Alpha at <http://seekingalpha.com/article/77942-pacific-capital-bancorp-q1-2008-earnings-call-transcript>.

<sup>125</sup> *Id.*

<sup>126</sup> PCB June 2008 Form 10-Q at 18.

SBBT has admitted that “RALs generally present the Company with some special funding and liquidity needs,”<sup>127</sup> *i.e.*, the bank has had problems maintaining adequate capital levels during RAL season because of the increased loan volume that it must fund, given the small size of the bank. This year, obtaining funds for RALs would have proven especially challenging given the current economic crisis. Indeed, SBBT’s President stated that “The disruption in the credit markets has restricted the availability of funding for the 2009 RAL and RT season. As a result, we may not be able to establish a securitization vehicle that we typically utilize for a portion of the funding.”<sup>128</sup>

However, taxpayer dollars have relieved SBBT’s funding problems in part. In November 2008, the U.S. Treasury Department approved SBBT as a recipient of \$180 million from the Troubled Assets Relief Program. Consumer groups, including NCLC and CFA, criticized both SBBT and the Treasury Department, for this use of taxpayer dollars to support RAL lending.<sup>129</sup>

In addition to Jackson Hewitt, SBBT makes RALs through independent preparers. As discussed in Appendix A, some of the most troubling examples of RAL abuse we have observed were from independent preparers. Mystery shopper testing conducted by CLS-Philadelphia and CRAN-NC found one independent preparer that charged over \$300 in add-on fees.<sup>130</sup> This preparer partnered with SBBT to make RALs.

#### E. Liberty Tax Service

Liberty Tax is the third significant commercial tax preparation chain in the country, with 3,000 locations.<sup>131</sup> It estimated that it would process about 1.3 million returns in 2008, with about 20% getting a RAL – or about 260,000.<sup>132</sup> The chain is well-known for hiring people to dress up in Statue of Liberty costumes as a form of advertisement during tax season.<sup>133</sup>

#### F. Republic Bank & Trust

Republic Bank & Trust is a state-chartered bank located in Louisville, Kentucky. Along with SBBT, Republic is the lending partner for Jackson Hewitt. Republic has also

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<sup>127</sup> *Id.* at 47.

<sup>128</sup> Pacific Capital Bancorp (PCBC), Transcript of Q3 2008 Earnings Call, November 21, 2008, from Seeking Alpha at <http://seekingalpha.com/article/107896-pacific-capital-bancorp-q3-2008-earnings-call-transcript>.

<sup>129</sup> Press Release, *Consumer Advocates Decry Use of Bailout Money to Make Predatory Loans to Working Poor Families*, Community Reinvestment Association of North Carolina, et al., Jan. 5, 2009.

<sup>130</sup> Durham/Philadelphia Mystery Shopper Report at Attachment 2.

<sup>131</sup> Liberty Tax Service, *About Liberty*, <http://www.libertytax.com/about-liberty-tax-service.html> (visited February 12, 2009).

<sup>132</sup> Michael Schwartz, *IRS Plan Irks Tax Firms*, Hampton Roads Business Journal, Jan. 21, 2008.

<sup>133</sup> Susanne Nadeau, *Face to face with Kim Northagen, Lady Liberty*, Grand Forks Herald, February 8, 2009.

vigorously pursued independent preparers, especially after HSBC ceased making RALs to most of this group.

In 2008, Republic made 525,650 RALs.<sup>134</sup> It earned \$2.8 million in net income from RALs and RACs in 2007, or about 11% percent of the bank's income.<sup>135</sup> Jackson Hewitt offices comprised about 70% of its RAL lending in 2007.<sup>136</sup> Republic also suffers from liquidity problems from its RAL business.<sup>137</sup>

In August 2008, Republic filed an application with the Office of Thrift Supervision to convert its regulatory status from a state-chartered bank, which is also supervised by the FDIC, to a federally chartered thrift. Consumer advocates, including NCLC and CFA, filed an opposition to Republic's application, in part because of Republic's RAL practices. This opposition pointed out that Republic might have sought a conversion in part to avoid supervision by the FDIC, which has recently stepped up its enforcement over abusive products offered by some of its supervised banks.<sup>138</sup>

Republic has a troubling history of offering other exploitive products to low-income consumers, such as Currency Connection, a product that enables check cashers and payday lenders to deliver Social Security, SSI and other benefits to unbanked recipients, charging them high fees for second class accounts and denying them control over their benefits. Republic had also made payday loans through third-party storefronts such as Advance America, until the FDIC made them stop.<sup>139</sup>

#### G. JP Morgan Chase

The most significant of the RAL lending banks not affiliated with Block or Hewitt is JPMorgan Chase. In 2008, Chase lowered its prices to a level comparable to H&R Block. However, it charged an additional \$10 "technology access fee" for 2008.<sup>140</sup> This fee essentially represented a payment to compensate the software providers/transmitters, because Chase has eliminated the per-RAL financial incentives to transmitters and preparers. As of 2009, Chase no longer charges this technology access fee.<sup>141</sup>

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<sup>134</sup> Letter from Steve Trager, CEO, Republic Bank to the Office of Thrift Supervision, September 23, 2008, in file with authors.

<sup>135</sup> Republic Bancorp, *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 6, 14. [Hereinafter "Republic 2007 Form 10-K"].

<sup>136</sup> *Id.* at 15.

<sup>137</sup> *Id.*

<sup>138</sup> NCLC, CFA, et al., *Opposition to Republic Bancorp OTS Application No. R2-2008-0202*, September 12, 2008.

<sup>139</sup> *Id.*

<sup>140</sup> JPMorgan Chase, *Application/Agreement for Chase Refund Anticipation Loan and/or Bonus Deposit Account – 2008*, on file with authors.

<sup>141</sup> JPMorgan Chase, *Application/Agreement for Chase Refund Anticipation Loan and/or Bonus Deposit Account – 2009*, on file with authors.

## H. Other Banks and Preparers

There are a handful of other banks that make RALs. For some reason, the two most significant banks, like Republic, are located in Louisville, Kentucky: River City Bank<sup>142</sup> and Fort Knox Financial Services/Ohio Valley Bank.<sup>143</sup> There are a handful of banks that may have small scale RAL operations.<sup>144</sup>

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<sup>142</sup> See [www.rcbral.com](http://www.rcbral.com).

<sup>143</sup> See [www.refund-advantage.com](http://www.refund-advantage.com).

<sup>144</sup> See, e.g., *Bohjanen v. Harwood State Bank (In re Bohjanen)*, 365 B.R. 916 (D.N.D. 2006).



## PART IV. REGULATION, ENFORCEMENT AND LITIGATION

### A. RAL Legislation

In September 2008, the federal Court of Appeals for the Second Circuit issued a decision striking down the interest rate caps of the Connecticut RAL Act.<sup>145</sup> The Second Circuit held that federal banking law preempts the Connecticut law, despite the fact that the law does not regulate what the banks can charge, but only prohibits third-party tax preparers from facilitating RALs over 60% APR. As a result, according to the Second Circuit, state legislatures are prohibited from limiting RAL fees. In response to the Second Circuit's decision, the Connecticut Attorney General and two legislators called on the state's Congressional delegation to pass federal legislation prohibiting RALs.<sup>146</sup>

In response to the Second Circuit's decision, NCLC has issued a new model state RAL law.<sup>147</sup> This revised model RAL law does not include any rate cap, which would be preempted under the Second Circuit's view. Instead, it prohibits add-on fees, *i.e.*, application, administrative, document preparation, "e-file" or "service bureau" fees that tax preparers impose only on RAL and RAC customers, but not all of their customers. It also limits RAL facilitation to businesses whose primary business is tax preparation and has new oral disclosures.

During 2008, one more state (New York) enacted a disclosure-only RAL law. There are currently a total of 13 states regulating RALs: California, Connecticut, Illinois, Minnesota, Nevada, New Jersey, New York North Carolina, Oregon, Tennessee, Texas, Virginia, Washington State, and Wisconsin. In addition, New York City has a RAL ordinance.

All of these laws are summarized in Appendix A to NCLC's model state RAL law. These laws primarily rely on disclosure to protect consumers from RAL abuses. A few laws require registration, which may help regulate some fringe preparers who facilitate RALs. We have seen that disclosures are limited in their effectiveness in addressing the problem of RALs.

On the federal level, as in 2007, the full House again passed a measure that would prohibit the IRS from providing the Debt Indicator in connection with RALs that the Treasury Secretary determines to be predatory based on practices and fees charged.<sup>148</sup> Of course, the IRS already has the authority to shut down the Debt Indicator and has adamantly refused to do so for years.

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<sup>145</sup> Pacific Capital Bank, N.A., v. Conn., 542 F.3d 341 (2<sup>nd</sup> Cir. 2008).

<sup>146</sup> Press Release, *Blumenthal, Sen. Duff and Rep. Barry Seek Protections against Predatory Tax Refund Anticipation Loans*, Connecticut Attorney General's Office, Jan. 23, 2009.

<sup>147</sup> Available at [http://www.consumerlaw.org/issues/refund\\_anticipation/content/RevisedMod eRALStatuteCommentary1208.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/RevisedMod eRALStatuteCommentary1208.pdf)

<sup>148</sup> H.R. 5719, 110<sup>th</sup> Congr. (2008).

Congressman Becerra and others again introduced the Taxpayer Bill of Rights Act of 2008,<sup>149</sup> which requires registration of RAL providers, better disclosures, and funding for free tax preparation programs and bank account pilot programs. Congresswoman McCarthy introduced a bill that would establish advertising and disclosure requirements for RALs<sup>150</sup>

## B. Enforcement

During 2008, a number of government agencies took enforcement actions involving RALs. In addition, we discuss updates to some earlier government actions.

### *California Attorney General Action*

The California Attorney General filed lawsuits against all three major tax preparation chains in 2006-2008. The lawsuits alleged that these companies made misleading statements in their promotion of RALs and RACs, violated consumer protection laws in their cross-lender debt collection practices, and violated IRS privacy rules regarding sharing of information for cross-marketing.<sup>151</sup>

In December 2008, Block agreed to enter into a settlement with the Attorney General, promising reforms of its practices and paying \$2.45 million in consumer refunds plus \$2.4 million in penalties and costs.<sup>152</sup> In addition, Block agreed to cease any deceptive or misleading marketing of RALs, and to make clear and conspicuous disclosures to consumers prior to their purchase of a RAL or RAC. The lawsuit against Jackson Hewitt had been settled in 2007.<sup>153</sup>

### *New Jersey Attorney General Lawsuit*

The New Jersey Attorney General's Office and Division of Consumer Affairs cited 38 tax preparers for deceptive advertising of RALs, following inspections of more than 600 businesses offering tax preparation.<sup>154</sup> The cited businesses advertised RALs as "instant," "same day," or day-specific ("1 Day" or "2 Day") refunds without disclosing that they were loans. The Attorney General is seeking a total of at least \$81,000 in fines for the violations of the New Jersey Consumer Fraud Act, plus \$9,500 for reimbursement of the state's investigative costs.

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<sup>149</sup> H.R. 5716, 110<sup>th</sup> Congr. (2008).

<sup>150</sup> H.R. 7188, 110<sup>th</sup> Congr. (2008).

<sup>151</sup> Complaint, *California v. JTH Tax, Inc.*, Case No. CGC-07-460778 (Cal. Super. Ct. Feb. 26, 2007); Judgment, *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Sup. Ct. Jan. 3, 2007); *People of California v. H&R Block*, 2006 WL 2669045 (N.D. Cal. Sep. 18, 2006).

<sup>152</sup> Judgment, *People of the State of California v. H&R Block*, Case No. 06-449461 (Cal. Sup. Ct. Dec. 31, 2008)

<sup>153</sup> Judgment, *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Sup. Ct. Jan. 3, 2007)

<sup>154</sup> Press Release, *Attorney General Anne Milgram Charges Tax Preparers Falsely Advertised "Same Day" Tax Refunds*, Office of the New Jersey Attorney General, Feb 5, 2009, available at <http://www.nj.gov/oag/newsreleases09/pr20090205d.html>.

The New Jersey Attorney General also filed a lawsuit with similar allegations against a local tax preparation chain, Malqui Corporation, in 2007.<sup>155</sup>

#### *New York State Division of Human Rights*

The New York State Division of Human Rights sued Jackson Hewitt and Liberty Tax Service for discriminatory targeting of minorities for RALs, in violation of that state's Human Rights Law.<sup>156</sup> H&R Block had attempted to preemptively stop an investigation that could lead to a similar lawsuit, but a New York state court held that federal law did not prohibit the New York agency from investigating Block.<sup>157</sup> Despite this decision, Jackson Hewitt has apparently filed a similar challenge against the Division of Human Rights' action, claiming federal preemption.<sup>158</sup>

#### *New York City Department of Consumer Affairs*

The New York City Department of Consumer Affairs (DCA) conducted another one of a series of investigations examining tax preparation firms for their RAL advertising. The DCA examined more than 430 tax preparation businesses and issued more than 1,200 citations to 150 of them. Top violations included deceptively advertising RALs as "rapid" or "instant" refunds. DCAs increased its inspections by 43% from the previous tax year.<sup>159</sup>

#### *Maryland Commissioner of Financial Institutions*

In 2005, the Maryland Commissioner of Financial Institutions issued an advisory warning tax preparers who assisted Maryland taxpayers in obtaining RALs that they were operating as credit services organizations (CSOs), and that they must be licensed and comply with Maryland's CSO law.<sup>160</sup> In response, H&R Block sued the Commissioner, alleging that federal law preempted the requirements of Maryland's CSO law because Block is serving as an agent of a national bank when it facilitates RALs. A federal court ruled partly in Block's favor, holding

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<sup>155</sup> Press Release, *State Sues Tax Preparation Firm Over Deceptive "Fast Refund" Offers*, New Jersey Attorney General's Office, March 5, 2007.

<sup>156</sup> Complaint, *New York State Division of Human Rights v. Jackson Hewitt*, Jan 17, 2008; Complaint, *New York State Division of Human Rights v. JTH Tax, Inc.*, Jan 17, 2008. *See also* Nicholas Confessore, *State Makes Bid to End Costly Tax-Refund Loans*, *New York Times*, Jan. 18, 2008.

<sup>157</sup> Decision/Order, *New York State Division of Human Rights v. H&R Block Tax Services*, Index No. 1726/2007 (Mar. 6, 2008), available at [http://www.dhr.state.ny.us/pdf/Court%20Orders/nysdhr\\_v\\_tax\\_preparers.pdf](http://www.dhr.state.ny.us/pdf/Court%20Orders/nysdhr_v_tax_preparers.pdf).

<sup>158</sup> Sweta Singh, *Jackson Hewitt Sues New York Agency Over Tax-Refund Loan Probe*, *Reuters*, Oct. 16, 2008.

<sup>159</sup> Press Release, *New York City Department Of Consumer Affairs Announces Citywide Enforcement Sweep Of Income Tax Preparers*, Feb. 5, 2009, available at [www.nyc.gov/html/dca/html/pr2009/pr\\_020509.shtml](http://www.nyc.gov/html/dca/html/pr2009/pr_020509.shtml).

<sup>160</sup> Maryland Commissioner of Financial Regulation, *Refund Anticipation Loans/Rapid Refund Program Advisory 05-01*, Jan. 24, 2005.

that federal law did preempt the fee caps and contract requirements of Maryland's CSO law, but not the licensing, bonding, and disclosure provisions.<sup>161</sup>

Prior to this court decision, the Commissioner had issued a follow-up advisory in May 2008 rescinding the first RAL advisory, stating that she was exercising her enforcement discretion and would not enforce the interest rate caps in the Maryland CSO law against RAL facilitators. However, all other provisions, such as licensing, disclosure and bond requirements, would be enforced.<sup>162</sup>

### C. Litigation

#### *Davis v. Pacific Capital Bank*<sup>163</sup>

This was one of the few, if only, lawsuits challenging pay stub RALs. The plaintiffs alleged that SBBT violated the Federal Rebate Act (codified as part of Truth in Lending) by failing to rebate a portion of the loan fee if the pay stub RAL was repaid prior to the due date of February 15th. This was a theory that NCLC had proposed.<sup>164</sup> Unfortunately, the Ninth Circuit Court of Appeals rejected the theory, holding that a flat finance charge is not "interest" under the Federal Rebate Act.

#### *Pinero v. Jackson Hewitt Tax Services*<sup>165</sup>

This a class action filed on behalf of over 100 Louisiana consumers whose tax returns and other financial documents were thrown in a public dumpster by Jackson Hewitt employees. These documents contained sensitive, confidential information, but were not shredded or otherwise destroyed before being placed in the dumpster. Plaintiffs alleged that the Jackson Hewitt franchisee's disposal of their records violated Section 6103 of the IRS Code, the Federal Trade Commission's Disposal rule, the Louisiana Security Breach Statute, and Louisiana consumer protection law.

#### *Watts v. Jackson Hewitt Tax Service*<sup>166</sup>

This lawsuit challenged both hidden RAL fees and deception in the advertising of tax preparation fees by a Jackson Hewitt franchisee with more than a dozen offices in New York and New Jersey. Plaintiffs alleged that the Hewitt franchisee

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<sup>161</sup> Decision, H&R Block Eastern Enterprises, Inc. v. Turnbaugh, Civ. Ac. No. 07-1822 (D. Md. July 30, 2008).

<sup>162</sup> Maryland Commissioner of Financial Regulation, *The Application of the Credit Services Business Act to Tax Preparers that Facilitate Refund Anticipation Loans*, Advisory 05-08, May 15, 2008.

<sup>163</sup> *Davis v. Pacific Capital Bank*, 550 F.3d 915 (9<sup>th</sup> Cir. 2008).

<sup>164</sup> *Pay Stub RALs: Potential Violations of Truth in Lending and the Federal Rebate Statute*, NCLC REPORTS - Consumer Credit and Usury Edition (Nov/Dec. 2006), at 9.

<sup>165</sup> First Amended Complaint, *Pinero v. Jackson Hewitt Tax Service*, Civ. Ac. No. 08-03535 (E.D. La. July 15, 2008).

<sup>166</sup> *Watts v. Jackson Hewitt Tax Service*, 579 F. Supp.2d 334 (E.D.N.Y. 2008).

advertised that its minimum fees were \$27 for a New York State long form and \$22 for a New York State short form. However, the franchisee automatically added a 15% multiplier to its tax preparation fee. In addition, the franchisee charged a hidden \$25 fee for RALs, on top of a disclosed \$75 application fee and the RAL loan fee.

The plaintiffs alleged that these hidden fees violated the New York consumer protection statute and New York City's RAL ordinance. A federal court denied the Hewitt franchisee's motion to dismiss the claims.

*Wooley v. Jackson Hewitt*<sup>167</sup>

This class action was fallout from the U.S. Department of Justice's enforcement action against five Jackson Hewitt franchisees that prepared fraudulent tax returns falsely claimed \$70 million in tax refunds. Plaintiffs were Jackson Hewitt customers who alleged that Hewitt preparers included false information on their returns without their knowledge, in violation of the Illinois state consumer protection statute and the Racketeer and Corrupt Organizations Act. Unfortunately, the federal court dismissed the plaintiffs' claims.

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<sup>167</sup> *Wooley v. Jackson Hewitt*, 540 F. Supp.2d 964 (N.D. Ill. 2008).

**APPENDIX A**  
***RALS, TAX FRAUD, AND FRINGE PREPARERS***

Chi Chi Wu, National Consumer Law Center  
Jean Ann Fox, Consumer Federation of America  
February 2009

For the past few years, NCLC, CFA, and other consumer groups have criticized RALs for the expense and risk they pose for consumers, especially low-income taxpayers. However, the harms of RALs are not limited to their impact on consumers. RALs have a negative impact on the integrity of tax administration as well. They promote tax fraud by preparers, and attract questionable players into the tax preparation business.

In fact, concerns over the adverse role of RALs in tax administration were significant enough for the IRS to open a rulemaking proceeding in 2008 asking whether the agency should develop rules restricting the sharing of tax return information to market RALs, RACs, audit insurance and other financial products.<sup>1</sup> The key question in this rulemaking was whether RALs and other tax financial products provide preparers with a financial incentive to inflate refund claims inappropriately.

NCLC, CFA and other consumer groups submitted extensive evidence indicating that RALs do provide tax preparers with an incentive to inflate refunds. Moreover, NCLC and CFA cited several statements by fraud experts and IRS criminal enforcers that RALs aid thieves in their commission of tax fraud. This report includes some of this evidence, as well as updates the findings with more recent information.

RALs also contribute to another negative phenomenon – they attract and promote fringe tax preparers. Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. They also include some retailers, such as jewelry and furniture stores, and businesses that offer travel, “notario,” and other services to immigrant communities. RALs provide the incentive for these fringe preparers to enter the business of tax preparation, sometimes with less than competent or savory results.

## **I. THE ROLE OF RALS IN ABETTING TAX FRAUD**

### **A. RALs Often Involved in Tax Fraud Cases**

NCLC/CFA and other consumer groups documented numerous examples of RALs being involved in cases of tax fraud. In preparing comments to the IRS’s RAL rulemaking, both NCLC/CFA and the Community Reinvestment Association of North Carolina (CRA-NC) conducted a review of published legal cases, materials posted on the websites of the U.S. Department of Justice and IRS, and media reports. Our respective reviews of this material found at least 58 cases of tax fraud in which the defendants used

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<sup>1</sup> 73 Fed. Reg. 1131 (Jan. 7, 2008).

RALs as a method of receiving their ill-gotten gains.<sup>2</sup> Subsequent to these reviews, another 11 cases were announced in mid to late 2008 involving RALs.<sup>3</sup>

These 69 cases alone would be a strong indicator that RALs assist criminals in committing tax fraud. However, the IRS itself has long known about the role of RALs in tax fraud, because IRS criminal investigators have noted the strong connection. In 2004, Gary Bell, then Director of the IRS Criminal Investigation Division's Refund Crimes Unit, reported that 80% of fraudulent e-filed returns were tied to a RAL or other refund financial product. Mr. Bell even explained the reasons why RALs enable tax fraud, noting that RALs offered fraudsters "an opportunity to get their cash and make a quick getaway."<sup>4</sup>

Nancy Jardini, Chief of the Criminal Investigations Division, reported similar data. In testifying before Congress, Ms. Jardini reported that 75% of tax returns identified as questionable and/or fraudulent were associated with a RAL.<sup>5</sup> In separate testimony, Ms. Jardini also noted that, in over 50% of cases of tax fraud committed by prisoners, the perpetrator requested either RALs or direct deposit refunds.<sup>6</sup>

In addition, RALs are the tool of choice for fraudsters who commit tax identity theft. In March 2008, a Wall Street Journal article about the growing problem of tax ID theft featured several cases in which RALs were used to perpetrate that crime.<sup>7</sup> The NCLC/CFA comments in the IRS rulemaking included several stories about taxpayers who were victimized by tax ID theft perpetrated using RALs.<sup>8</sup>

In 2007, a Senate Finance Committee hearing on tax fraud and ID theft featured the testimony of Evangelos Dimitros Soukas, who netted over \$40,000 by stealing the identities of other taxpayers as well as making up false returns. Mr. Soukas was initially

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<sup>2</sup> Comments submitted by Community Reinvestment Association of North Carolina regarding Advance Notice of Proposed Rulemaking - Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products, April 7, 2008, at Attachment B, *available at* <http://www.cra-nc.org/files/Download/CRANC%20FINAL%20Comment%20Letter%20on%20RALs.pdf> [hereinafter "CRA-NC Comments to IRS RAL ANPR"]. Comments of National Consumer Law Center, Consumer Federation of America, et al. regarding Advance Notice of Proposed Rulemaking - Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products, April 7, 2008, at Appendix B, *available at* [http://www.consumerlaw.org/issues/refund\\_anticipation/content/comments\\_040708.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/comments_040708.pdf). [hereinafter "NCLC/CFA Comments to IRS RAL ANPR"]

<sup>3</sup> See Addendum.

<sup>4</sup> Allen Kenney, *IRS Official Shines Spotlight on E-Filing Fraud*, 2004 Tax Notes Today 130-4, July 6, 2004.

<sup>5</sup> Statement of Nancy J. Jardini, Chief, Criminal Investigation, Internal Revenue Service, *Testimony before the Subcommittee on Oversight of the House Committee on Ways and Means*, July 20, 2005, *available at* <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=2921>.

<sup>6</sup> Statement of Nancy J. Jardini, Chief, Criminal Investigation, Internal Revenue Service, *Testimony before the Subcommittee on Oversight of the House Committee on Ways and Means*, June 29, 2005, *available at* <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=2875>.

<sup>7</sup> Tom Herman, *Identity Thieves Target Tax Refunds*, Wall Street Journal, March 12, 2008.

<sup>8</sup> Appendix D to NCLC/CFA Comment to IRS RAL ANPR.

attracted to the crime of tax identity theft and tax fraud because of a RAL website advertisement, and used RALs in his criminal schemes.<sup>9</sup>

The most prominent tax fraud case was the U.S. Department of Justice (DOJ) civil enforcement action filed April 2, 2007, against 5 Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns falsely claiming \$70 million in tax refunds. DOJ alleged that the owners and managers of these franchisees “created and fostered a business environment ... in which fraudulent tax return preparation is encouraged and flourishes.” Examples of fraud alleged by DOJ included filing false returns claiming refunds based on phony W-2 forms; using fabricated businesses and business expenses on returns to claim bogus deductions; claiming fuel tax credits in absurd amounts for customers clearly not entitled to any credits; and massive fraud related to Earned Income Tax Credit (EITC) claims.<sup>10</sup>

According to the complaints filed in these lawsuits, RALs were heavily involved in the fraud committed by these Jackson Hewitt franchisees. The lawsuits against all of the franchisees alleged:

Many of [franchisees’] stores cater to prospective customers who are not entitled to tax refunds but who seek to obtain fast money in the form of Jackson Hewitt "Holiday Express Loan Program" (HELP) loans, "Money Now" loans, or Refund Anticipation loans (RALs) secured by fabricated tax refunds fraudulently claimed on Jackson Hewitt prepared and filed tax returns.<sup>11</sup>

In addition, one of the lawsuits alleged: “In 2007, a Smart Tax/Jackson Hewitt return preparer offered to fraudulently manipulate a customer's 2006 return information so the customer would qualify for a RAL.”<sup>12</sup>

The complaints also suggested that RALs contributed to an atmosphere that encouraged fraudulent tax preparation, in part due to a sense that it was not the preparer’s responsibility to look out for or stop fraud. For example, one complaint noted that the franchise owner told an employee not to reject returns with false Form W-2s, stating “fraud detection is the job of the police and Santa Barbara Bank & Trust” (Jackson Hewitt’s RAL lender).<sup>13</sup>

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<sup>9</sup> Statement of Evangelos Dimitros Soukas, *Testimony before the Senate Finance Committee*, April 12, 2007.

<sup>10</sup> 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>.

<sup>11</sup> *Id.*

<sup>12</sup> Complaint, *United States v. Smart Tax Inc.*, 07C-1802 (N.D. Ill. Apr. 2, 2007).

<sup>13</sup> Complaint, *United States v. Smart Tax of Georgia, Inc.*, 1:07CV-0747 (N.D. Ga. Apr. 2, 2007).



## B. Studies Finding RALs Associated with Tax Fraud

Numerous studies, both investigative and statistical, suggest that RALs are involved in cases of inflated refunds. These studies have been conducted by consumer groups, private foundations, government investigators, and the IRS's own researchers. They include:

(1) A 2008 study by IRS researchers analyzing different sets of tax returns that had been audited, some with RALs or RACs and others without. This study found "propensity scoring methods indicate that there is a significant correlation between taxpayers who use RALs and noncompliance. RAL users are 27 percent - 36 percent more noncompliant than taxpayers who do not use a bank product."<sup>14</sup> The researchers did caution that the higher rates of noncompliance by RAL users does not prove that RALs *cause* tax fraud.

(2) A 2008 sting operation by the New York Department of Taxation and Finance that found evidence of fraud among about 40% of the 85 tax preparers that they visited<sup>15</sup>

(3) In 2006, the Government Accountability Office (GAO) conducted mystery shopper testing of 19 tax preparers.<sup>16</sup> The GAO found errors that led to inflated refunds exceeding \$1,000 in 6 out of the 19 test cases. These inflated refunds resulted from preparers not reporting business income in 10 of 19 cases and claiming an ineligible child for the EITC in 5 out of the 10 applicable cases. The GAO report specifically noted that RALs were often offered by these paid preparers.

(4) Mystery shopper testing by CRA-NC in Durham, and Community Legal Services of Philadelphia (CLS-Philadelphia) by testers seeking RALs found multiple instances of tax preparation that would have led to inflated refunds.<sup>17</sup>

- One CRA-NC tester had to withdraw from mystery shopper testing because of preparer incompetence in the treatment of income from dividends. The preparer was confused about how to handle dividend income and needed to consult her "tax people" for advice. After a consultation, she advised the tester that it was not necessary to report the dividend income, essentially instructing the tester to commit tax fraud. Furthermore, preparer also

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<sup>14</sup> Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, *Do Products Offering Expedited Refunds Increase Income Tax Non-Compliance*, Office of Research, Analysis and Statistics, Internal Revenue Service, 2008, at 15, on file with authors.

<sup>15</sup> Tom Herman, *New York Sting Nabs Tax Preparers*, Wall Street Journal, Nov. 26, 2008.

<sup>16</sup> Government Accountability Office, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T, April 4, 2006, available at <http://www.gao.gov/new.items/d06563t.pdf>.

<sup>17</sup> Chi Chi Wu, Kerry Smith, Peter Skillern, Adam Rust, and Stella Adams, *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, April 2008, ("Durham/Philadelphia Mystery Shopper Report")

completely missed profits from the sale of stock shares, which also must be reported as income.

- A Jackson Hewitt preparer failed to include unemployment insurance income in the return of a married couple who served as CLS-Philadelphia testers. This omission substantially understated the couple's income. This couple was required to file an amended return in order to correct this omission.

(5) Impact Alabama conducted similar mystery shopper tests of 13 tax preparers.<sup>18</sup> Its testers found that 11 of the 13 preparers incorrectly claimed the EITC. In addition, 10 preparers did not report income from other jobs such as babysitting, 8 did not report interest income, and 12 allowed testers to claim "head of household" status without being qualified for it.

None of the testers should have qualified for refunds, but each preparer figured a refund ranging from \$65 to \$6,247. One tax return that showed a \$6,247 refund was prepared by a fringe preparer, Columbus Finance Company, for a taxpayer who actually owed \$112 to the IRS. Impact Alabama reported that these preparers promoted RALs to the testers.<sup>19</sup>

(6) The National Taxpayer Advocate's 2007 Report to Congress noted that when IRS audited EITC tax returns associated with RALs, they found errors in 87% of cases, versus 73% of the cases without RALs – a 14% difference. Furthermore, returns with RALs resulted in adjustments of tax liability that averaged 10% more than non-RAL returns.<sup>20</sup>

(7) A study conducted for a private foundation compared error rates in returns from both free tax preparation sites and commercial preparers, finding much higher error rates in the latter – 41% in free sites versus 73% in commercial sites.<sup>21</sup> The errors in commercial sites were also larger in dollar amount and more likely to overestimate the refund than underestimate (40% of the commercial preparer returns overestimated the refund, but only 8% of the free site returns overestimated the refund). Part of the reason for these higher error rates, tilted toward inflated refund amounts, may be the financial incentives provided by RALs and RACs, since the nonprofit free sites have no similar financial incentive.

### C. RALs Provide Preparers With Financial Incentives to Push the Loans, Which May Lead to Inflated Refunds

RALs provide significant financial incentives to preparers. These incentives encourage preparers to sell RALs, and to take measures that promote loans. In turn, those

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<sup>18</sup> Impact Alabama, *Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis*, Jan. 2009, on file with authors.

<sup>19</sup> Steve Doyle, *Group Uncovers Tax Cheaters*, Huntsville Times, Jan. 23, 2009.

<sup>20</sup> National Taxpayer Advocate, *FY 2007 Annual Report to Congress*, December 31, 2007, at 88.

<sup>21</sup> Amy Brown, *Quality in Free and Commercial Tax Preparation: Results from the 2006 Tax Season*, Annie E. Casey Foundation, June 2006.

measures may result in preparers sometimes inflating a taxpayer's refund. These incentives include:

- Some preparers receive a kickback per RAL. For example, Republic Bank & Trust advertises on its website a kickback “incentive” payment of \$6 per RAL.<sup>22</sup> At one point, all of the major RAL lending banks offered these kickbacks. Santa Barbara Bank & Trust still does, paying \$3 per RAL plus an additional payment of \$1 to \$3 depending on the loan performance of RALs facilitated by the preparer.<sup>23</sup>
- Previously, Block employees had been compensated per RAL or RAC. Individual Block employees no longer receive compensation for these products, but the company does. Block buys a 49.9% “participation share” from HSBC in each RAL facilitated by Block.<sup>24</sup>
- Currently, Hewitt receives a lump sum from RAL lenders plus “a variable payment upon the attainment of certain contractual growth thresholds.”<sup>25</sup> In prior years, Hewitt's share of loan profits was even more explicit. Hewitt's 2004 Securities and Exchange Commission prospectus describes how the company received \$16 plus a potential additional \$2 plus 50% of any profit over 1% of the aggregate loan volume of RALs. In other words, Hewitt received a significant percentage if not the majority of profits from RALs, but shared in a 50% risk if loan defaults resulted in a net loss to the bank.<sup>26</sup>
- The biggest incentive is for independent preparers, who can charge one or more separate add-on fees, sometimes called “application,” “administrative,” “e-filing,” “service bureau,” “transmission,” or “processing” fees. These add-on fees are on top of the RAL loan fee charged by the bank, and can range from \$25 to several hundred dollars.
- H&R Block and Jackson Hewitt preparers also charged add-on fees until these chains agreed to drop them. These fees could be quite steep. For example, one Jackson Hewitt franchisee was sued for charging a hidden \$25 RAL fee on top of a disclosed \$75 application fee.<sup>27</sup>

IRS regulations specifically prohibit preparers from basing their fees on the refund amount.<sup>28</sup> However, the above compensation structures undermine this protection by compensating preparers for generating loans. On a corporate level, both Block and

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<sup>22</sup> <https://www.republicrefund.com/ERO-Support/ERO-Incentives.aspx>.

<sup>23</sup> Santa Barbara Bank & Trust, *Bank Product Program 2009*, November 2008.

<sup>24</sup> H&R Block Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 6, available at <http://www.sec.gov/Archives/edgar/data/12659/000095013707009521/c16312e10vk.htm>.

<sup>25</sup> Jackson Hewitt Tax Service Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 22, available at <http://www.sec.gov/Archives/edgar/data/1283552/000119312507147353/d10k.htm>.

<sup>26</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 39, available at <http://ccbn.10kwizard.com/cgi/convert/rtf/JACKSONHEWITTTA424B1.rtf?rtf=1&repo=tenk&ipage=2856162&num=-3&rtf=3&xml=1&dn=2&dn=3>.

<sup>27</sup> *Watts v. Jackson Hewitt Tax Service*, 579 F. Supp.2d 334 (E.D.N.Y. 2008).

<sup>28</sup> IRS Publication 1345.

Hewitt have shared in the profits or risks of the loans, which are dependent on the loan amounts (and thus refund amounts). Furthermore, preparers have incentives to inflate refunds when RALs are involved because:

- While a larger RAL does not mean more compensation for the preparer on an individual basis, a bigger refund and RAL means the independent preparer can charge a higher fee in that the taxpayer becomes less sensitive to the amount of tax preparation fees.
- A larger refund also means a taxpayer is more likely to get a RAL. Taxpayers are more likely to get a RAL for a \$3,000 refund (costing \$62 to \$114) than a \$500 refund (costing \$35 to \$43).
- For retailers who offer tax preparation and RALs, such as used car dealers and furniture stores, the bigger refund means the retailer can sell a more expensive product. A bigger refund also means a bigger check cashing fee for the check casher who prepares taxes, or more money to pay off a loan for payday lenders and pawn shop operators.

Finally, RALs and other financial products, such as RACs, often permit preparers to handle the payment mechanism (check or prepaid card). This provides another opportunity for malfeasance on the part of the preparer. In several cases, including at least three of the RAL fraud cases described in CRA-NC's comments,<sup>29</sup> the preparer illegally endorsed a RAL check and deposited it into its own bank account.<sup>30</sup> This is especially easy because the tax preparer is the one who prints a RAL check or issues a prepaid card – indeed, the preparers often are provided blank check stock to print out RAL checks. In contrast, if a taxpayer receives a paper check from the government or a direct deposit, s/he has direct control over the funds when first issued.

Finally, RALs may provide incentives to inflate refunds simply because they draw fringe preparers into the field, as discussed in Section II.F below. The quality of preparation services by fringe preparers is questionable, and may result in inflated refunds.

#### D. The Speed of RALs Makes Tax Fraud Easier for Criminals

One reason that RALs encourage tax fraud is the speed by which the fraudster receives loan proceeds. Such reasoning is not only intuitive and logical, it was pointed out to the IRS over 15 years ago. In 1993, the IRS commissioned a report on electronic filing fraud by Dr. Malcolm Sparrow, an expert on fraud at Harvard's Kennedy School of Government. In his report, Dr. Sparrow informed the IRS:

Most importantly, the existence of RALs has acted as an attractor for fraud by shortening the "exposure period" for the perpetrators. The exposure period -- the time that elapses between the carrying out of a dishonest act and the receipt of the financial payoff from that act -- is one of the most powerful deterrents for fraud

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<sup>29</sup> CRA-NC Comments to IRS RAL ANPR at Attachment B.

<sup>30</sup> The Addendum to this report describes four other similar cases.

available. It is a very uncomfortable period for the criminal as they have to, in some sense, stay contactable or available to the authorities in order to receive their reward. In the paper system the processing delays, although never designed explicitly as fraud controls, acted as such.

The existence of RALs has brought the exposure period right down to 48 hours, which, for a simple to execute fraud with a \$ 3,000 reward, is incredibly fast and therefore extremely attractive when compared with other fraud opportunities. "Easy money fast" is a much more attractive proposition for fraud perpetrators than "easy money . . . which you should get in six weeks."<sup>31</sup>

Thus, the role of RALs in fraud is something the IRS has been aware of since 1993, and indeed was the reason that the agency terminated the Debt Indicator in the following year. Unfortunately, the IRS chose to reinstate the Debt Indicator in 1999, and as discussed in Section I.E. below, both the number of RALs and tax fraud skyrocketed.

The federal government's own financial crimes experts came to the same conclusion as Dr. Sparrow. The Treasury Department's Financial Crimes Enforcement Network (FinCEN) raised concerns about the role of RALs in promoting fraud in August 2004. FinCEN issued a warning to banks that month, noting the fraud potential of RALs: "To make this type of loan appealing to the public, funds are made immediately available, leaving little time for the lender to perform due diligence to prevent fraud."<sup>32</sup>

Other commentators have made similar observations. For example,

- As noted above, Gary Bell of the IRS Criminal Investigations Division noted that the speed of RALs enables fraudsters to make a quick getaway. Mr. Bell further explained "it may take the IRS three or more weeks to process the return [using fraud detection measures], especially in the peak of the spring filing season. Meanwhile, the RAL lenders have processed the loan within a couple of days of the return being filed, the money is in the hands of the bad guys, and they can disappear without a trace..."<sup>33</sup>
- Steven Saltzburg, a Georgetown University law professor who was the director of a Treasury Department task force on tax fraud, stated that "the refund anticipation loan system made it easy for criminals with false papers to steal up to \$3,300, the maximum refund anticipation loan amount, but because the I.R.S. pays the banks within two weeks and rarely pursues recovery, the taxpayers often end up as the losers."<sup>34</sup>

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<sup>31</sup> Malcolm Sparrow, *Fraud In The Electronic Filing Program: A Vulnerability Assessment Prepared for the Internal Revenue Service*, Sept. 1, 1993, at 10.

<sup>32</sup> FinCEN, SAR Activity Review, Issue 7, August 2004, at 15-17.

<sup>33</sup> Gail Perry, *Electronic Filing Fraud: Latest Tax Scam's Got Legs*, Accounting Today, August 9, 2004, at 3.

<sup>34</sup> David Cay Johnston, *Bank Challenges I.R.S. on Refunds for Borrowers*, New York Times, Feb. 22, 1995.

- Unnamed tax officials quoted in the New York Times observed that RALs “allow them [fraudsters] to get the money for their fraudulent returns before the fraud can be detected by the I.R.S.”<sup>35</sup>

#### E. Experience with the Debt Indicator

The IRS experience with the Debt Indicator also provides an indication of how RALs promote fraud. In 1994, the IRS terminated the Debt Indicator due to concerns over mounting fraud in refund claims.<sup>36</sup> IRS data during that time period had indicated that 92% of fraudulent returns filed electronically involved RALs.<sup>37</sup>

After the Debt Indicator was terminated, the number of RALs dropped – at H&R Block, RAL volume was cut in half from 5.5 million to 2.35 million. The elimination of the Debt Indicator and the corresponding decrease in RALs appeared to have had its intended effect of cutting down fraud. According to the then Assistant Attorney General in charge of the Tax Division at the Department of Justice, eliminating the Debt Indicator, along with other fraud prevention measures, successfully reduced the number of fraudulent claims.<sup>38</sup>

When IRS reinstated the Debt Indicator in 1999, the number of RALs increased as a result. In reinstating the Debt Indicator, the IRS attempted to address fraud by requiring tax preparers to institute fraud prevention measures. Despite these new measures, fraud increased when the Debt Indicator was reinstated, and the number of RALs went up. Gary Bell of IRS’s Criminal Investigations Division noted in 2004 that e-file fraud increased by more than 1,400% since 1999 (when the Debt Indicator was reinstated), and that approximately 1 in every 1,200 e-filed returns was phony, compared with a rate of about 1 in every 5,000 four years earlier. The FinCEN report also noted that RAL fraud had multiplied between 2000 and 2003.<sup>39</sup>

#### F. Banks Have Little Incentive to Institute Fraud Control Beyond IRS’s Controls

Another reason that RALs contribute to tax fraud is that banks have little incentive to reduce fraud beyond reliance on IRS’s own measures. As Dr. Sparrow described in his report to the IRS:<sup>40</sup>

This raises an interesting point with respect to the banks' incentives. Their profit motive provides no incentive at all for them to detect fraud; they have a financial

<sup>35</sup> Robert D. Hershey Jr., *Administration Moves Against Tax Credit*, New York Times, Oct. 27, 1994.

<sup>36</sup> A history of the Debt Indicator, its termination and subsequent reinstatement, and its impact on the RAL industry is set forth in Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*, National Consumer Law Center (July 2005).

<sup>37</sup> George Guttman, *Improper Refunds Sapping Billions*, 66 Tax Notes 19, October 3, 1994, at 23.

<sup>38</sup> John Tigue & Linda Lacewell, *Tax Litigation – Interview with Loretta C. Argrett – Part II*, New York Law Journal, July 17, 1997.

<sup>39</sup> FinCEN, SAR Activity Review, Issue 7, August 2004, at 15-17.

<sup>40</sup> Malcolm Sparrow, *Fraud In The Electronic Filing Program: A Vulnerability Assessment Prepared for the Internal Revenue Service*, Sept. 1, 1993, at 23.

incentive only to predict IRS behavior. The [Debt Indicator] has been, this year, an excellent predictor of IRS behavior, so they had a very profitable year. Note that they decline 6% or 7% of applications because the [Debt Indicator] comes back negative, whereas they decline only 0.5% of applications on the basis of their own fraud detection systems. So the [Debt Indicator] is doing nearly all of their selection work for them.

The banks argue that they behave as good citizens, care deeply about fraud control, and are not solely guided by the profit margins. They do, however, monitor each [tax preparer] BY THEIR LOSS RATE, and cut off those [tax preparers] that become unprofitable for the banks. (emphasis in original).

Despite the banks' protestations that they deeply care about fraud, some RAL banks up until recently continued to do nothing more than mimic the IRS's controls. As long as the IRS paid the refund, these banks treated their fraud controls as sufficient. One bank even admitted it left fraud controls off when they thought IRS wasn't screening. The CEO of Santa Barbara Bank & Trust admitted:

The reason why we didn't have it [fraud control] on all the time before is because we had a history with the IRS over their own fraud control and we mimicked, or tried to mimic the IRS' fraud control. So we would turn on when we thought the IRS would turn on its fraud control, and for many years, 10 or 15 years, that served this bank very, very well. It allowed the bank to balance revenue growth with loss control.<sup>41</sup>

Indeed, SBBT did not even employ a bank officer in its RAL division who was responsible for credit quality. As one investment analyst noted: "risk management was a little sparse."<sup>42</sup>

This sparse risk management and piggybacking on IRS fraud controls continued until 2007, when SBBT suffered significant losses from RAL fraud and after the IRS had instituted new controls. While SBBT instituted new measures in 2008, there is nothing to prevent it from reverting back to mimicking IRS fraud controls once the bank can be assured that it has "gamed" the controls and can determine whether the IRS will pay the refund. After all, during the years prior to IRS's institution of better fraud controls, SBBT knew it would be making loans against some fraudulent returns but accepted it so long as the bank knew it would get repaid from the U.S. Treasury.

A reversion to mimicry once the RAL banks figure out the post-2007 IRS fraud controls would be expected given the financial incentives for the banks. RAL banks have a significant incentive NOT to run fraud controls that exceed or are different from IRS fraud controls, because that lowers the bank's approval rate and results in a decrease in profit. For example, SBBT predicted that its RAL volume would decrease by 5% due to

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<sup>41</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, October 29, 2007, at 14.

<sup>42</sup> *Id.* at 10.

its new fraud controls that are different from the IRS fraud controls.<sup>43</sup> That translates into about 90,000 RALs. Given that SBBT charges \$106 for a typical RAL, these stronger fraud measures cost SBBT nearly \$10 million in foregone RAL fees. As SBBT's CEO put it:

I think the fact of the matter is this is a volume driven business, and the guys in San Diego worked very hard to sort of balance the risk requirements with the revenue generating issues of that business; and we patterned the fraud control, in particular, on behaviors that the IRS had done for many, many years.<sup>44</sup>

## II. RALS AND FRINGE PLAYERS

RALs cause harm to low-income taxpayers and promote shady tax preparation another way: by attracting fringe preparers into the business.

### A. The Independent Sector

Independent preparers have a large share of the commercial tax preparation market. According to data from the IRS, there were 79 million returns prepared by paid tax preparers in 2007.<sup>45</sup> In 2007, Block prepared 15.7 million returns, Jackson Hewitt prepared 3.65 million returns, and third largest chain, Liberty Tax, prepared about 1 million returns.<sup>46</sup> This adds up to slightly more than 20 million returns. Thus, independent preparers prepared nearly 59 million tax returns, or almost three-quarters of all paid preparer returns, in 2007.

There is little data as to how many RALs were sold through these independent preparers. We know that at one point, HBSC/Household had a relationship with approximately 5,600 tax preparers, most of whom we assume were independent.<sup>47</sup> We also know that H&R Block and Jackson Hewitt only accounted for about 5.25 million of the 8.67 million RALs made in 2007.<sup>48</sup>

Independent preparers can range from licensed professionals, such as attorneys and certified public accountants, to any person who wishes to hang a “shingle” and make money preparing taxes. The federal government regulates return preparers very minimally, and only three states (California, Maryland, and Oregon) license preparers. While there are many independent preparers who are just as experienced and well trained

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<sup>43</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, Nov. 1, 2007, at 5.

<sup>44</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, October 29, 2007, at 10.

<sup>45</sup> Data from IRS SPEC, Return Information Database for Tax Year 2006 (Returns Filed in 2007), Jan. 2009.

<sup>46</sup> Main Report at Part III, *supra*, at 26-30.

<sup>47</sup> Household International, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 7, available at <http://www.sec.gov/Archives/edgar/data/354964/000095013703001680/c75016e10vk.txt>.

<sup>48</sup> See Main Report, Part III, *supra*, at 26-28.



– if not more so – than the commercial chains, there is a sector of independent preparers that is extremely problematic – the fringe preparers.

Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. Some retailers, such as jewelry and furniture stores, are fringe tax preparers. In immigrant communities, businesses that offer travel services, “notario” services, and quickie divorces also often offer tax preparation of varying quality.

## B. The Supporting Cast for Fringe Preparers

A scan of websites in early 2009 reveals a variety of tax preparation and RAL offers from check cashers, rent-to-own stores, payday lenders, and others. These stores offer tax preparation either by using software in-house to prepare tax returns or through off-site preparers.

### 1. *Software providers*

Many fringe preparers are able to exist because of the software and back office support of certain companies called “transmitters,” “service bureaus,” or “software developers.” Examples include NTS Service Corp., Drake Software, Universal Tax Systems, Petz Enterprises, OrrTax and Refunds Today. These companies sometimes serve as the “electronic return originator” for the fringe preparer, *i.e.*, these companies are the ones authorized by the IRS to electronically file tax returns.

For example, Petz Enterprises advertises its Tax Software and Financial Products or “QuickAccess” to check cashers, noting that “you get to keep a percentage of every transaction.”<sup>49</sup> EZ Income Tax offers its tax software and RALs to check cashers for \$199.<sup>50</sup>

Refunds Today sells a package of interview software, e-filing, on-site refund check printing, marketing materials, and staff training to businesses who want to offer tax preparation and “Fast Tax Refunds” to their customers.<sup>51</sup> Refunds Today’s website claims:

With EZ Refund, you put quick tax refund checks in your customer’s hands and put smiles on their faces. You also increase your own income while expending little effort to earn it. EZ Refund requires absolutely no tax preparation or electronic filing knowledge. It’s simple. You gather the data, we prepare the taxes. Customers pay nothing out of pocket. You shorten the tax preparation and refund process down to minutes, instead of weeks. And you make money doing it!<sup>52</sup>

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<sup>49</sup> Quick Access ad, *Cheklis*, Winter 2007, at 31.

<sup>50</sup> EZ Income Tax ad, *ChekList*, Fall 2008, page 11.

<sup>51</sup> Refunds Today ad, *CheckList*, Fall 2008, page 29.

<sup>52</sup> [https://ez-refund.refundstoday.com/rt/ez\\_index.cfm](https://ez-refund.refundstoday.com/rt/ez_index.cfm), visited Feb. 16, 2009.

Check City, a chain of payday lenders, promotes use of Drake Enterprises' Lightning Tax Service at its stores.<sup>53</sup> Lightning Tax Service also partners with 1040.com to provide online tax preparation.<sup>54</sup> No information on the cost of financial products is available at either website.

There are transmitters that specifically cater to used car dealers, *e.g.*, Tax Refund Services, which operates as TaxMax. Tax Max was formed from the merger of three programs (Tax Refund Services, Tax Max and Tax Deals 4 Wheels) and is based in Tampa, Florida. It claims that 3,000 car dealerships offer its tax products.<sup>55</sup> TRS touts its products by claiming that over 50% of taxpayers receiving a refund spend the entire amount in 48 hours and that offering tax preparation and RALs increases down payments on cars by \$1,000 to \$5,000 per deal.<sup>56</sup>

TRS offers the Tax Max 4<sup>th</sup> Quarter Sales Program as a form of pay stub RAL lending, making loans in expectation that tax refunds will be available later. It helps dealers calculate an approximate tax refund for potential car buyers, then negotiate a future down payment based on that estimate. Customers sign a promissory note for the loan, permitting cars to be sold in October, November, and December before tax season starts. TRS recommends that dealers require customers to bring in payments every week or two weeks until they return with IRS Form W-2s to file the tax return. TRS suggests that dealers get clients to write personal checks for the amount of the "Tax Refund Advance" which the dealer holds until the RAL pays the down payment, a variation of payday lending. In addition, TRS recommends that dealers use starter interrupter devices to "manage the customer's behavior and help ensure that the customer maintains payments," and to move old inventory by only offering a limited choice of vehicles to these consumers.<sup>57</sup>

TRS also provides traditional RALs when tax season starts at a cost of \$139 for tax preparation plus \$48 to \$139 in RAL fees.<sup>58</sup> Dealers are permitted to charge up to \$99 to "organize the tax documents" for a total of \$238 in tax preparation fees.<sup>59</sup> The RAL check is made payable to the taxpayer, but the check is sent to the dealership, and the customer is expected to endorse the check over to the dealership. TRS claims that RALs sent electronically are sent directly to the car dealer's bank account.<sup>60</sup>

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<sup>53</sup> <http://www.checkcity.com/lightningtax/>, visited Feb. 6, 2009.

<sup>54</sup> <https://fileonline.1040.com/default.aspx?did=21047>, visited Feb. 23, 2009.

<sup>55</sup> <http://www.taxrefundsolutions.com/Site/TRSTaxMax/AboutUs.aspx>, visited Feb. 11, 2009.

<sup>56</sup> <http://www.taxrefundsolutions.com/Site/TRSTaxMax/Benefits.aspx>, visited Feb. 11, 2009

<sup>57</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMax/FourthQuarterSalesProgram.aspx>, visited Feb. 11, 2009

<sup>58</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMax/HowItWorks.aspx>, visited Feb. 11, 2009

<sup>59</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMax/FAQ.aspx>, visited Feb. 11, 2009

<sup>60</sup> *Id.*

## *2. Remote Tax Preparation Services Sold Through Storefront Financial Service Outlets*

Other fringe preparers operate by sending their customers' information to offsite tax preparers. TaxOne is a remote location tax preparation service provided by H&R Block to payday lenders, check cashers and other fringe financial outlets. Customers complete a Tax Information Organizer questionnaire at the partner outlet, and are instructed to bring their IRS Form W-2s, Form 1099s, a government issued photo ID, Social Security cards for all family members, and other requisite tax documents. The information is transmitted to TaxOne for preparation. Consumers return to the outlet to review the completed tax return and decide on "which fast money option works best for you."

TaxOne allows the fringe financial outlet to promote RALs. TaxOne RALs are made by Santa Barbara Bank & Trust and BanComer. The RAL prices appear to be similar to Block's in-store prices.<sup>61</sup> While the RALs may be less expensive than other providers and the quality of tax preparation better than at other payday lenders, the downside is that TaxOne allows payday loan chains to keep their customers coming through the doors during a time of year when typically the demand for payday loans drops. Some of the payday lenders and fringe financial providers using TaxOne include Check into Cash, MoneyTree, Advance America, Allied Cash Advance, and U.S. Money Shops.<sup>62</sup>

In addition, using a remote service to prepare tax returns and sell RALs or RACs raises privacy and security issues, as sensitive information is passed back and forth between two or more entities. Payday lenders using TaxOne will complete a taxpayer's worksheets and documents, then scan and transmit them to the H&R Block staff to prepare the tax returns. TaxOne's website says that paper copies of tax information are returned to the taxpayer and not kept at the fringe financial outlet. Information is transmitted via a secure HTTPS site with 128 bit encryption with client-host authentication, according to the preparer's FAQs.

Both a privacy and security policy are posted for TaxOne.<sup>63</sup> However, the consent forms required under Section 7216 of the IRS code are not initially handed out along with the TaxOne Organizer at storefront outlets or posted on the TaxOne website. The H&R Block training materials for TaxOne state that clients are to be provided the IRS-required consent-to-disclose forms to sign in order to permit their personal information to be shared with TaxOne for tax preparation purposes. Outlets are also required to provide consent-to-use forms for customers to authorize tax return information to be used to provide RALs.<sup>64</sup>

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<sup>61</sup> For example, taxpayers are charged a \$30.95 account set-up fee plus a \$28 finance charge for a \$2,700 RAL, which is similar to Block's fees. [http://www.taxone.com/fast\\_money\\_options.aspx](http://www.taxone.com/fast_money_options.aspx), visited Feb. 10, 2009.

<sup>62</sup> [www.taxone.com/find\\_locations.aspx](http://www.taxone.com/find_locations.aspx), visited Jan. 28, 2009.

<sup>63</sup> <http://www.taxone.com/faq.aspx>, visited Feb. 10, 2009.

<sup>64</sup> Email from H&R Block, TaxOne Training Document excerpt, Feb. 1, 2009, on file with authors.

Another question about TaxOne is the price of tax preparation. MoneyTree quotes a tax preparation fee “as low as \$79” but notes that pricing is based on each customer’s tax situation and the complexity of the return.<sup>65</sup> The promotional brochure for Check into Cash’s TaxOne service promotes RALs, but does not provide cost information for either tax preparation or RAL/RAC products.<sup>66</sup> However, its website states TaxOne preparation service starts at \$79 and directs consumers to a customer service representative to provide a personalized price quote.<sup>67</sup>

Another remote tax preparation company, Liquid Tax, offers its remote tax preparation services to rent-to-own stores, check cashers, used car lots, barber shops, convenience stores, beauty supply shops, pawn shops and outlets that sell prepaid telephone cards. Taxpayer documents are faxed to Liquid Tax’s office in Atlanta and the RAL checks are printed at storefront retailers who “convert loyal customers into additional revenues by providing basic tax prep services.” Dealers are promised up to \$100 in commission per return.<sup>68</sup>

Liquid Tax uses Drake Software to process tax returns and sell RALs.<sup>69</sup> Taxpayers fill out a form that the brick and mortar store faxes to the staff at Liquid Tax. The completed tax return and refund confirmation is faxed back within a half hour. A description of this product at the rent-to-own industry’s trade website says that the client returns the next day to “pick up his refund check that is printed on the spot.”<sup>70</sup> Of course, the check is for the proceeds of a RAL since IRS refunds are not processed in 24 hours.

Other tax preparation companies also advertise remote preparation services to check cashers and payday lenders. For example, Ultimate Tax Service offers check cashers a way to increase revenue by charging to prepare returns, then charging to cash the checks. Information is entered “into the system,” the remote preparer completes the return, and “you print the Refund Loan Checks in your office.”<sup>71</sup>

### C. Prevalence and Motivation of Fringe Financial Providers in the Tax Preparation Field

Tax refunds have a significant impact on high cost lenders such as payday loan outlets and pawn shops. Typically, loan volume trends downward early in the year as

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<sup>65</sup> [www.moneytreeinc.com/106/Tax-Services.htm](http://www.moneytreeinc.com/106/Tax-Services.htm), visited Feb. 10, 2009.

<sup>66</sup> TaxOne brochure from Check into Cash Payday Advance Centers, obtained at Prescott, AZ store, Feb. 2, 2009.

<sup>67</sup> [www.checkintocash.com/products/tax-service/taxone.htm](http://www.checkintocash.com/products/tax-service/taxone.htm), visited Jan. 28, 2009.

<sup>68</sup> Press Release, *Liquid Tax’s Powerful, Speedy Solution Converts Loyal Customers into Additional Profits*, PRWeb.com, Oct. 15, 2008, available at <http://www.prweb.com/printer/1471614.htm>, visited Feb. 10, 2009.

<sup>69</sup> *Strong Partners: Liquid Tax Grows its Practice Through Unique Partnerships*, Taxing Subjects, at <http://www.taxingsubjects.com/Archives/issue24/art2.html>, visited Feb. 10, 2009.

<sup>70</sup> *Dave Oliver Adds Liquid Tax to First American Home Furnishings Lineup*, RTOonline.com, Dec. 8, 2008.

<sup>71</sup> Ultimate Tax Service ad, ChekList, Winter 2008, at 23.

consumers with payday or pawn loans use RAL and refund proceeds to take a break from the payday loan debt treadmill. For example, the Oklahoma Department of Consumer Credit reports on the volume of payday loans issued by month. Loan volume dropped 6.3% in January 2008 (90,109) over December 2007 (95,745) and another 12.8% drop in February (78,590) compared to January.<sup>72</sup>

Some payday lenders and other high cost lenders have responded by setting up tax preparation services and offering RALs and RACs. These fringe financial providers benefit both by keeping their customers coming to them and from the fees for selling tax preparation, RALs, and cashing RAL/tax refund checks. Pawn shops and rent-to-own stores can also sell items to customers with refunds or RAL cash in hand.

An industry news service claims that the typical rent-to-own store has 400 customers and could make \$20,000 in tax prep fees if half choose to have their taxes prepared at the store.<sup>73</sup> A Georgia rent-to-own manager described the case for tax preparation and RALs: “as customers cash those checks, we’ll see them again soon, paying off merchandise, taking advantage of early buyouts as well as cash sales. That’s a big revenue source for us on top of commissions for processing their tax return.”<sup>74</sup>

One of the nation’s largest rent-to-own chains, Rent-a-Center, offers tax preparation and refund loans through Tax AdvantEdge. Clients are instructed to bring tax documents to the store location and complete a questionnaire to collect basic personal information online. Rent-a-Center’s RALs are provided by Santa Barbara Bank & Trust. Rent-A-Center advertises that it will cash tax refund checks. Cost information is not posted on Rent-a-Center’s website.<sup>75</sup>

Check cashers benefit both from traditional check cashing fees as well as offering other payment devices for RALs and refunds. For example, Dollar Financial Group’s Money Mart, a chain of check cashing stores, markets its Momentum prepaid debit card to receive tax refund deposits. ACE Cash Express offers either check cashing at its 1,700 stores or can load a refund onto a prepaid debit card provided by NetSpend, issued by Inter National Bank or MetaBank. ACE is offering a tax sweepstakes prize of \$5,000 to customers who load at least \$250 of their tax refund/RAL on the debit card and register their debit cards online.<sup>76</sup>

Another fringe financial provider that offers tax preparation and RALs is Cash America, a large pawn and payday loan operation. Cash America advertises a free estimate on the size of the customer’s tax return with no up front fees. Cash America promotes instant RALs, RALs and RACs on its website. The fine print notes that tax

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<sup>72</sup> Oklahoma Department of Consumer Credit, *Oklahoma Trends in Deferred Deposit Lending*, June 2008, available at <http://www.OK.gov/okdocc/documents/DDL%20Program%20Effectiveness%20Report.pdf>

<sup>73</sup> “Rent-to-Own Dealers Capitalize on Fast Tax Refunds,” RTOonline.com, November 12, 2008.

<sup>74</sup> “Economy Presents Rental Dealers with Tax Service Revenue Opportunity,” RTOonline.com, December 3, 2008.

<sup>75</sup> <http://www.raffinancialservices.com/site/page/pg3092.html>, visited Feb. 10, 2009.

<sup>76</sup> [http://www.acecashexpress.com/ss\\_taxprep.php](http://www.acecashexpress.com/ss_taxprep.php), visited Feb. 11, 2009.

preparation and financial products are provided by third-party vendors that are responsible for all claims regarding their products.<sup>77</sup>

In order to get a sense of the magnitude of high cost lenders involved in tax preparation, NCLC/CFA's comment to the IRS reviewed the lists of entities that are authorized e-file providers for five states, available on the IRS website.<sup>78</sup> The following chart summarizes our review of the number of fringe preparers included in the e-file provider list for these five states:

<b>State</b>	<b>Fringe Lenders/Providers</b>	<b>Percentage of Authorized e-file Providers</b>
Arizona	213	5.0 %
Florida	351	2.5
Illinois	240	2.7
Massachusetts	19	0.4
South Dakota	17	3.7

Some of the high cost lenders listed on the IRS website include:

- Ace Cash Advance (11 locations, AZ)
- Check Advance (20 locations, AZ)
- Loan Mart (31 locations, AZ)
- Money Mart (32 locations, AZ)
- Cash AdvantEdge (10 locations, AZ)
- A Florida's Cash Express (FL)
- Bay Auto Loan Cash Advance (FL)
- Cash 4 U (FL)
- Check Man (6 locations, FL)
- Fast Money Inc (2 locations, FL)
- Flash Cash Services (FL)
- Instant Cash Advance (2 locations, FL)
- Mr. Cash & Assoc. (FL)
- Melrose Jewelry & Pawn (FL)
- Calumet City Currency Exchange (IL)
- Colortyme (rent-to-own store) (2 locations, IL)
- Dupage Currency Exchange (IL)
- Peoples Choice Cash & Pawn (IL)
- Security Finance (55 locations, IL)
- Quick Pay (MA)
- EZ Money Check Cashing (SD)
- Money Lenders (3 locations, SD)

<sup>77</sup> <http://www.cashamerica.com/FinancialServices/TaxFilingServices.aspx>, visited Feb. 16, 2009

<sup>78</sup> <http://www.irs.gov/efile/page/0,,id=10162,00.html>.

Washington State requires outlets that facilitate the sale of RALs to register with the Department of Financial Institutions. For 2009, the approximately 617 locations that are registered include fringe financial service providers Rent-a-Center Tax AdvantEdge (18 locations), MoneyTree (60 locations), and Advance America payday loan outlets (approximately 100 locations). Both MoneyTree and Advance America use H&R Block's TaxOne tax preparation and RAL service.

Small loan installment lenders also offer tax preparation services during tax season. Sun Loan Company, with outlets in several western states, offers tax preparation, e-filing and RALs.<sup>79</sup> Both World Acceptance Corporation and Security Finance offer tax preparation services through their small loan outlets. Security Finance links to 1040 Tax Services to prepare online tax returns as well as offering in-store tax preparation.

#### D. Other Questionable Preparers

Fringe financial outlets are not the only dubious businesses offering tax preparation services. The review of the IRS list of authorized e-file providers for the five states uncovered additional questionable fringe preparers, such as:

- Arizona Auto Title Co. (AZ)
- Statons Home Furnishings (AZ)
- U Haul International (AZ)
- 4 J'S Auto Sale & Services, LLC (FL)
- A D Used Cars (FL)
- Babcock Home Furniture (FL)
- Buddy's Home Furnishings (54 locations, FL)
- Cherilus Driving School (FL)
- Delilah Ephraim Beauty Salon (FL)
- Jays Stucco & Plastering (FL)
- Jolinda Beauty Supply and Service (FL)
- Lithos Jewelry (FL)
- Lundys Liquor (FL)
- Rent a Wheel (9 locations, FL)
- Aloha Travel & Tax Services (IL)
- Benton Super Lube (IL)
- Paradise Super Market (IL)
- Belmar Travel & Tour (MA)
- New Age Oriental Therapy (MA)
- Union Travel & Tours (MA)<sup>80</sup>
- A to Z Language Interpreters (SD)
- Appliance & Furniture Rent All Inc (5 locations, SD)

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<sup>79</sup> <http://www.sunloan.com/taxreturns.asp>, visited Feb. 11, 2009.

<sup>80</sup> Union Travel & Tours was sued by the Massachusetts Attorney General's Office for offering quickie Dominican divorces that were not valid in the United States. Kathy McCabe, *Fee Refunds Ordered For Invalid Divorces*, Boston Globe, July 23, 2000.



Even one airline has gotten into the business. AirTran offers its frequent fliers tax preparation and financial products through online tax preparation by TaxProSolutions.com.<sup>81</sup> A GAO study found tax preparation and RALs being offered by used car dealers, a van rental store, a trailer in a gas station parking lot, and a shoe store that offered a free pair of shoes with tax preparation.<sup>82</sup>

Thus, businesses engaged in tax preparation and potentially offering RALs include used car dealers, travel agents, beauty salons, furniture stores, grocery stores, jewelry stores, liquor stores, and a “therapy” office. Needless to say, we wonder about the quality of preparation at these businesses. We question why the IRS has been permitting these businesses to become authorized e-file providers. The Treasury Inspector General for Tax Administration has noted the deficiencies in IRS oversight of the e-file provider program.<sup>83</sup>

#### E. The Problem with Fringe Tax Preparers

A fundamental problem with fringe preparers is the questionable quality of tax preparation. While software providers and remote tax preparation locations do offer back office support, often the retail salesperson at the fringe preparer is actively engaged in the preparation. The fringe preparer often asks the taxpayer the important questions, gathers the documentation, and enters it. For example, TaxMax provides used car dealers with a tax questionnaire that asks detailed questions about qualifications for the EITC such as “Was EIC Denied Last Year or Did You Receive an IRS Request to Qualify Your Childs Residency. If Yes Was Form 8862 or 8836 Completed to Qualify.”

The testing conducted by CLS-Philadelphia and CRA-NC found several instances of incompetent tax preparation, including by one fringe preparer who essentially advised the tester to commit tax fraud. Testing conducted by Impact Alabama found even more instances of incompetent or fraudulent tax preparation, including a small loan company that prepared a tester’s return to show a \$6,247 refund when the tester actually owed \$112 to the IRS.<sup>84</sup>

Even some independent and chain preparers that specialize in taxes provide questionable quality. An article on a small independent chain called “Mo’ Money Taxes” notes that about 10 to 15% of their customers end up with a RAL but no refund from IRS.<sup>85</sup> That 10-15% “loss” rate is extremely high – much higher than the 1 to 2% loss rate reported by the RAL banks in general.

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<sup>81</sup> AirTran Airways A-Savers email Feb. 12, 2009, on file with authors.

<sup>82</sup> Government Accountability Office, *Refund Anticipation Loans*, GAO-08-800R, June 5, 2008, available at <http://www.gao.gov/new.items/d08800r.pdf>.

<sup>83</sup> Treasury Inspector General For Tax Administration, *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program*, Reference No. 2007-40-176, September 19, 2007.

<sup>84</sup> Impact Alabama, *Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis*, Jan. 2009, on file with authors.

<sup>85</sup> Wendi C. Thomas, *Your Super-Fast Refund Comes with Strings That Pull Back*, Tennessee Commercial Appeal, Jan. 28, 2007.



Fringe tax preparers also have been known to file tax returns without a W-2. An IRS spokesperson in Georgia noted that “[o]ffering to file a tax return with merely a pay stub, for example, may be a gimmick used ‘primarily to entice taxpayers to pay extra fees for extra services that they may or may not need.’”<sup>86</sup>

Another problem with some fringe preparers is that, while the commercial chains at least claim to make disclosures that RALs are loans, fringe preparers sometimes don’t even bother trying. The most recent example of this comes from the New Jersey Attorney General, who cited 38 independent tax preparers for deceptive advertising of RALs.<sup>87</sup> These preparers advertised RALs as “instant,” “same day,” or day-specific (“1 Day” or “2 Day”) refunds without disclosing that they were loans. Some of the preparers were fringe preparers or otherwise involved in other business such as:

Amigo Travel Express  
Apple Immigration & Tax Services  
DPS Professional Tax Service & Realty Management  
Ejecutivo Travel Agency and Services  
Guadalupe Galvan a/k/a Aero Travel & Taxes  
J-B Deli, Grocery and Multiservices LLC  
Johnny Zorilla a/k/a Accurate Accounting House a/k/a Zorilla Check Cashing  
Suramericana Travel, Inc.  
Tropical Agency, Puerto Rico Viajes Inc.  
U.S.A. Family Management, Inc.

The New Jersey Attorney General also filed a lawsuit with similar allegations against a local tax preparation chain, Malqui Corporation, in 2007.<sup>88</sup>

Fringe preparers also aggressively promote fast tax “refunds.” Some of the examples of fringe preparers and their advertisements included in the NCLC/CFA Comment to the IRS were:

- (1) Buddy’s Home Furnishings in Bradenton, Florida, which the manager described as issuing an “instant check” for tax returns, but refused to disclose the fee structure.<sup>89</sup>
- (2) Serpentine Chevy in Cleveland advertised: “We’ll Do Your Taxes For Free And Double Your Refund,” then used tiny type to disclose that the “tax refund bonus” was limited to \$500, and had no mention that a loan was involved.

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<sup>86</sup> Susan McCord, *W2 or no W2?*, Albany Herald, Feb. 18, 2008.

<sup>87</sup> Press Release, *Attorney General Anne Milgram Charges Tax Preparers Falsely Advertised “Same Day” Tax Refunds*, Office of the New Jersey Attorney General, Feb 5, 2009, available at <http://www.nj.gov/oag/newsreleases09/pr20090205d.html>.

<sup>88</sup> Press Release, *State Sues Tax Preparation Firm Over Deceptive “Fast Refund” Offers*, New Jersey Attorney General’s Office, March 5, 2007.

<sup>89</sup> Brian Neill, *Fast-Cash Tax Returns Come with Price*, Bradenton Herald, Feb. 1, 2008.

(3) Car Credit City advertised: “Take \$20 Off Your tax service. File your taxes at Car Credit City and driver away in a quality vehicle. All you need is – Your 2007 W-2 – Driver’s License – Social Security Card – 2 most recent pay stubs – Proof of Residency (utility bill or piece of mail).”

(4) Dollar Financial Group’s advertisements for its Money Mart stores promise to “Turn your refund into fast cash! With a RAL for \$200 to \$9,500 by check in one to three days or an instant RAL for up to \$1,700 with the balance of funds payable with a RAL in one to three days.”<sup>90</sup>

(5) Preparers who use names that imply the taxpayer can receive a refund quickly. The review of authorized e-file providers in five states from the IRS website<sup>91</sup> revealed names such as:

- AA Next Day Tax Cash (4 locations, AZ; 4 locations, FL; SD)
- Home of Next Day Tax Cash (AZ; 4 locations, FL; SD)
- Rapido Express Income Tax Services (AZ)
- ASAP Rapid Refund Tax Service (FL)
- Instant Refund (3 locations, FL)
- Instant Tax Service (49 locations, AZ; 34 locations, IL)
- Magic Tax Refund (4 locations, FL)
- Quick & Easy Rapid Refund (FL)
- Quick Refunds (FL; 13 locations, IL)
- Quick Cash Tax Services (FL)
- Quick & Easy Rapid Refund (FL)
- Rapid Tax Refund (FL)
- Refunds Express (FL)
- Super Fast Express Refunds (FL)
- Kai’s Rapid Tax Refund Service (IL)
- Next Day Tax Cash (4 locations, IL; 2 locations, SD)
- Xpress Refunds Tax Service (IL)
- Williams Rapid Refund (IL)
- Fast Tax Back (MA)
- Tax Man Refund Express (MA)

(6) TaxStar Online<sup>92</sup> advertises:

The Tax Refund Program brings customers to your location when you advertise a FREE Instant Tax Refund Estimate. Most people are anxious to find out how much money they will get back and you provide that useful service. You simply enter a few items from the customers W-2 into the Online Estimator, or onto the paper form and fax to us, and we instantly estimate the amount of tax refund they

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<sup>90</sup> [www.moneymart.com/MM/tax.asp](http://www.moneymart.com/MM/tax.asp), included in Appendix F.

<sup>91</sup> <http://www.irs.gov/efile/page/0,,id=10162,00.html>.

<sup>92</sup> <http://dealers.taxstaronline.com/benefits.php>, visited Feb. 20, 2009.

should receive. You will know in minutes how many refund dollars you have available.

Larger Down Payments. Close more deals with the extra \$3,000 to \$5,000 available for a down payment from your customer's tax refund. It makes financing easier and qualifies the customer for a wider selection of your inventory. And there is no long wait for the cash; we can have the refund deposited directly into your bank account, or you can print a Refund Anticipation Loan check, directly from your computer, in as little as 12 hours.

#### F. RALs Encourage Fringe Players to Become Tax Preparers

RALs and RACs encourage fringe players to enter the field of tax preparation. There would be much less incentive for used car dealers, shoe stores, and payday lenders to be involved in tax preparation without RALs and RACs, because:

- (1) The fringe preparer would not be the arranger of the financial product used to pay for goods and services, and the transaction would lack the "seamless" nature that encourages taxpayers to spend their refunds with the fringe preparer.
- (2) The fringe preparer could not obtain control of the financial product proceeds, *i.e.*, if there were no RALs and RACs, tax refund monies would always be paid directly to the taxpayer by mail or direct deposit. The RAL or RAC allows the fringe preparer/retailer to physically hold the funds or check, especially since the preparer is the one that issues the check or cards.
- (3) The fringe preparer could not extract tax preparation, document processing, e-filing or other add-on fees from the proceeds of a RAL or RAC.
- (4) The fringe preparer would not receive the per-RAL fees that RAL lenders pay to preparers in making a RAL.

Thus, the elimination or restriction of RALs would have the added advantage of reducing the number of questionable fringe preparers in the commercial tax preparation field.

### **III. CONCLUSION**

For many years, consumer advocates have urged the Congress, the IRS, and other policy makers to ban or restrict RALs. As this report shows, banning RALs will benefit more than consumers. It will reduce tax fraud and promote the integrity of our tax system. It will eliminate one incentive that attracts fringe players into the tax preparation field. Banning or restricting RALs is a win-win for everyone, except those who profit from these predatory loans.

**ADDENDUM: LIST OF TAX FRAUD CASES INVOLVING RALS  
FROM MARCH 2008**

United States v. Legro, 284 Fed. Appx. 143 (5<sup>th</sup> Cir. July 2, 2008) (Bernita Legro prepared false returns claiming average of \$2,172 in telephone excise tax; obtained at least \$700,000 in RALs for the fraudulent refunds).

*Local, State Staff Reports*, Tulsa World, Jan. 7, 2009, at A16 (Cynthia Williams used RALs to inflate refund amounts claimed in clients' tax returns)

Ed Richter, *Local Man Enters a Guilty Plea for Filing False Tax Returns*, Middletown Journal, Dec. 1, 2008 (Patrick Hill created false W-2s and obtained fraudulent refunds using RALs).

Press Release, *Detroit Man Sentenced for False Refund Claims to IRS*, U.S. Attorney's Office for the Eastern District of Michigan, Nov. 24, 2008 (Booker T. Gregory, Jr. assisted in filing 36 false returns claimed using RALs).

Ben Finley, *Tax Preparer Guilty of Fraud*, Bucks County Courier Times, Nov. 20, 2008 (Aneza Abalo targeted Liberian community, falsifying her clients' returns with fake deductions; took cut of clients' refunds using RALs).

*Tax Fraud Lands Atlanta Man in Federal Prison*, Atlanta Business Chronicle, Oct. 31, 2008 (Antonio Millege Adams assisted others in filing false returns by creating fake W-2s; to ensure that he received his fee plus a portion of the fraudulent refund, he directed filers to seek RALs).

Press Release, *Fishers Woman Charged with Filing 47 False Tax Returns*, U.S. Attorney's Office for the Southern District of Indiana, Oct. 9, 2008 (Lori Crisp prepared false returns at H&R Block office stealing identities of other individuals, then received RALs for these returns, which she cashed).

Press Release, *Federal Court Shuts Down Chicago Tax Preparer*, U.S. Dept. of Justice, Oct. 3, 2008 (Debra Windham, former IRS secretary, filed phony returns for unwitting customers and applied for RALs without the customer's knowledge, then took a portion of the loan proceeds).

John Eligon, *Tax Preparer is Charged with Theft on L.I.*, New York Times, Apr. 10, 2008 (Diana Aliffi stole identities of other individuals to file false returns, obtained RALs from JPMorgan Chase, and had RAL checks sent to her so she could deposit them into her own account).

Press Release, *President of Takoma Park Tax Preparation Business Sentenced for Preparing False Tax Returns*, U.S. Dept. of Justice, Apr. 21, 2008 (Jiten Mehta filed returns on behalf of clients using fake deductions and obtained RALs for these clients from which he deducted fees).

Press Release, *Detroit Man Goes to Jail for Defrauding the Internal Revenue Service*, U.S. Attorney's Office for the Eastern District of Michigan, Mar. 11, 2008 (Kenneth Felder recruited and assisted nine other individuals to file false returns with fake W-2s and apply for RALs).