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The Campaign
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Tax Preparers Confuse and Abuse Mystery Shoppers in Durham and Philadelphia

*Consumer Advocates Urge IRS to Stop Tax Preparers from
Using Confidential Tax Returns to Sell Refund Anticipation Loans and
Other Products*

The 70 million taxpayers who pay commercial firms to prepare tax returns are at risk of confusion, abuse, and errors by tax preparers selling costly refund anticipation loans (RALs), according to a new report and comments filed with the Internal Revenue Service. This week, advocacy groups released a report on mystery shopper testing, entitled "*Tax Preparers Take a Bite out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia.*" The report was also sent to the Internal Revenue Service as part of consumer comments filed in the IRS rulemaking on use of tax returns to market RALs.

The mystery shopper tests portray an industry that imposes high costs on vulnerable low-income filers and fails to provide high quality tax preparation. Preparers in Philadelphia and Durham, NC, failed to tell taxpayers about free filing options, and some failed to disclose that RALs are loans. Preparers made serious errors on some testers' returns, which would have resulted in inflated refunds, and failed to correctly handle education credits or investment income. Many preparers did not give clear price information about RALs, other products, and tax preparation fees, leaving testers confused and unable to comparison shop.

"Taxpayers put their trust, their financial health, and their liability for taxes in the hands of commercial preparers," noted Chi Chi Wu, Staff Attorney at National Consumer Law Center "Unfortunately, that trust may not always be well placed."

Mystery Shoppers Test a Variety of Tax Preparers

Seventeen “mystery shopper” tests were conducted at H&R Block, Jackson Hewitt, Liberty Tax service and independent preparers by the Community Reinvestment Association of North Carolina (CRA-NC) in Durham and by Community Legal Services of Philadelphia (CLS) and the Philadelphia Campaign for Working Families. The National Consumer Law Center (NCLC) analyzed test results for the report.

All of the testers had their taxes prepared by commercial preparers. Fifteen of these testers received RALs or a refund anticipation check (RAC).¹ (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. Even when testers were told that a RAL is a loan, many preparers did not give clear price information about RALs, RACs, and tax preparation fees. Only one preparer in either city informed the tester how to receive a fast, free refund by e-file and direct deposit. A few testers were given RALs or RACs by default, while others were automatically required to pay charges for RACs for state refunds.

Several preparers made serious errors that significantly affected tax liability, causing two testers to file amended returns to fix errors. One tester withdrew after a preparer advised him to essentially engage in tax fraud, even telling test coordinators “My experience with [the independent preparer] has been a scary one. I say that mainly because 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 ancillary 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.

We engaged in testing because we had concerns about the cost of RALs to working families,” said Peter Skillern of the Community Reinvestment Association of North Carolina. “The surprise to us was seeing firsthand just how unreliable the preparers were in handling the tax filing needs of consumers. Preparers made a lot of mistakes.”

Community Legal Services (CLS) of Philadelphia has conducted its own mystery shopper tests of commercial tax preparers for the past three years, and joined with other groups this year to expand the test. “Year after year, our mystery shoppers’ experiences reveal that some commercial tax prep companies confuse and abuse their customers with poor disclosures, high fees and costly miscalculations,” said Kerry Smith, an attorney with CLS. “It’s time for the IRS to take action to ban the marketing of expensive, risky refund anticipation loans.” CLS is a partner with The Campaign for Working Families, which operates 16 free tax sites in Philadelphia.

¹ 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 check and closes the temporary account.

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

Consumer Advocates Urge IRS to Protect Tax Return Privacy in Rulemaking on RALs

Advocates from NCLC and Consumer Federation of America (CFA) sent the mystery shopper report to the IRS Monday as part of their submission to the agency's rulemaking on RALs. The IRS is considering issuing a proposal to prohibit tax preparers from sharing tax return information to sell RALs, RACs, and other products. The IRS specifically asked for feedback on whether RALs and other products provide an incentive to inflate tax refunds, and whether these products exploit low-income taxpayers.

In addition to the mystery shopper report, consumer advocates provided extensive documentation that RALs do indeed exploit low-income taxpayers, promote tax fraud, and expose confidential tax returns to prying eyes. RALs carry high costs and risks, and drain hundreds of millions from the Earned Income Tax Credit (EITC), a special tax benefit to working poor families. RALs cost between \$32 to \$130 in loan fees, plus the ancillary fees, and can translate into high Annual Percentage Rates (APRs) of 50% to 500%. RALs drained \$900 million from the refunds of American taxpayers in 2006, plus \$90 million in other fees. Nearly two-thirds of RAL borrowers are EITC recipients, despite the fact that only 17% of taxpayers get the EITC. (More information on the financial impact of RALs on taxpayers is available at http://www.consumerlaw.org/issues/refund_anticipation/content/RAL_2008PressRelease.pdf)

Many consumers do not understand that a RAL is a loan – the result of years of misleading promotion shown by government enforcement actions, investigations and private lawsuits, some even from this year. RALs also enable commercial preparers to withhold information on tax preparation fees, make taxpayers less sensitive to the price of preparation, and allow certain preparers to pad their prices with multiple, ancillary RAL-related fees. In one case, a tester in Philadelphia was charged \$324 in ancillary fees.

Consumer advocates provided extensive documentation of the link between tax fraud and RALs, including several dozen criminal cases. The advocates noted that many experts on fraud, including the Treasury Department's financial crimes experts, a Harvard professor fraud specialist, and even IRS's own criminal investigators had made the connection between RALs and fraud.

RALs also promote the existence of fringe tax preparers, who are attracted by the financial incentives for RALs and/or taxpayers' ability to use loan proceeds to buy merchandise. A review of IRS authorized e-file providers from five states found hundreds of fringe preparers, including payday lenders, pawn shops, rent-to-own stores, auto title lenders, used car dealers, travel agents, beauty salons, furniture stores, grocery stores, jewelry stores, liquor stores, and a "therapy" office.

Consumer advocates also noted the privacy risks posed by RALs and other financial products sold at tax time. Tax preparers share confidential return information with RAL banks by getting the taxpayer to sign a consent form, which is easily slipped into the stack of documents that taxpayers are told to sign.

“The IRS currently permits tax returns to be shared with entities it does not control,” said CFA’s Jean Ann Fox. “Once tax returns are in the hands of banks and others, consumers have little say over how that information is used.”

A copy of consumer advocates’ comments to the IRS is at http://www.nclc.org/issues/refund_anticipation/content/comments_040708.pdf.

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

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

The Community Reinvestment Association of North Carolina is a nonprofit agency that promotes and protects community wealth.

For over 40 years, Community Legal Services Inc. (CLS) of Philadelphia has provided the highest quality legal assistance to low-income Philadelphians who cannot afford legal counsel when they most need it.

The Campaign for Working Families operates 16 free tax sites throughout Philadelphia (prepare and e-file federal and state income tax returns), and connects individuals to the federal Earned Income Tax Credit (EITC), other tax credits, public benefits, and asset-building resources. www.phillyfreetaxes.org.