



Consumer Federation of America



**Consumer Action**  
Education and Advocacy Since 1971

April 9, 2007

Dear Senator,

The undersigned consumer, advocacy and free tax preparation groups write to urge you to pass strong legislation to regulate high cost, high risk refund anticipation loans (RALs). We appreciate the fact that the House Ways & Means Committee has passed a measure to prohibit the IRS from providing the Debt Indicator in connection with RALs that the Treasury Secretary determines to be predatory. However, we believe additional, more comprehensive provisions are required to adequately address the significant problems posed by RALs.

As you know, RALs are secured by or expected to be repaid from the consumer's tax refund. They carry effective Annual Percentage Rates of 40 percent to over 500 percent, and put the taxpayer at risk of unmanageable debt if the IRS denies or reduces the expected refund. RALs drained about \$1 billion from the refunds of nearly 10 million taxpayers in 2005, the latest year for which IRS data is available.

We also write to urge you to include the following provisions in any RAL bill that you introduce or support:

**1. A Ban on RALs Made Against the Earned Income Tax Credit (EITC)**

Tax preparers and their bank partners should be prohibited from making loans secured by or expected to be repaid from the EITC. The EITC is the nation's largest anti-poverty program, and its benefits should go to its intended beneficiaries, not be skimmed off by large banks and multi-million dollar corporations.

EITC recipients are disproportionately represented in the ranks of those who get RALs. Over half of the nearly 10 million taxpayers who received RALs in 2005 were EITC recipients, yet EITC recipients make up just 17% of the taxpayer population. That year, RALs cost EITC recipients an estimated \$649 million in loan fees plus application or document processing fees.

That \$649 million represents federal anti-poverty funds, intended to help working poor families, that were diverted to the coffers of multimillion dollar corporations to pay for high cost, high-risk loans. Congress must put an end to this blatant form of corporate profiteering.

There is ample precedent for prohibiting loans to be made against federal benefits such as the EITC. Other government programs have similar prohibitions, some of which have existed for decades. For example, the Social Security Act, 42 U.S.C. § 407(a), prohibits lenders from seizing, garnishing, attaching, taking an assignment in, or securing a loan against Social Security benefits.

We would also recommend that any RAL law must address pre-tax filing pay stub and “holiday” RALs. Pay stub and holiday RALs present the latest line of products designed to drain tax refund dollars from the pockets of American consumers. These are RALs made prior to the tax filing season, before taxpayers receive their IRS Form W-2s and can prepare and file their returns. They present additional costs and risks to taxpayers. They will allow the RAL industry to continue to drain tax refunds even after the IRS reduces refund delivery times to a few days as promised.

## **2. Regulation of Tax Preparers**

Any effort to reform RALs should address the role of commercial tax preparers in promoting these loans. There is a common perception in this country that tax preparers are accountants, CPAs or other kind of credentialed professional. Yet with the exception of two states, there are no competency or certification requirements for commercial tax preparers. Many states regulate hair salons better than tax preparers. As a result, anyone can be a paid preparer, including used car dealers, payday lenders, and the occasional furniture store. The National Taxpayer Advocate has repeatedly urged better regulation of paid preparers as one of her priorities, and the Government Accountability Office has also noted the problems with regulation of commercial tax preparers.

Despite this lack of professional certification or licensing, taxpayers rely heavily on paid preparers. There is a strong degree of trust in the tax preparation relationship. This trust relationship creates enormous potential for exploitation, including with respect to RALs and other products sold by preparers.

The commercial tax preparation industry must be better regulated, with requirements for licensing or certification, minimum training standards, and continuing education. In addition, there must be legal protections that recognize and protect the strong trust relationship between a taxpayer and her tax preparer and prevent self-dealing, such as the establishment of a fiduciary duty.

However, any regulation of commercial tax preparers should not preempt the ability of the states to enact stronger laws that are more protective of consumers. The states have been the laboratories of innovation with respect to consumer protection, and must have the ability to continue to develop protections as industry practices evolve in response to regulation.

## **3. Funding for Free Tax Preparation Programs**

A critical component to preventing RALs is to provide better alternatives to the paid preparers who pitch RALs. These alternatives include free tax preparation programs, especially those provided by organizations that are part of the IRS Volunteer Income Tax Assistance (VITA) program. These include programs run by AARP, community organizations, churches, and local governments. There are a number of large and very successful programs in cities such as

Chicago, Minneapolis, and Philadelphia. However, there are too few in many parts of the country to meet the needs of low-income taxpayers. In 2006, there were several million return filers with incomes below the poverty threshold, yet there was only enough volunteer or free help to prepare 698,000 returns.

Thus, federal funding for VITA programs and free tax preparation is critical. The National Community Tax Coalition is spearheading an effort to approve \$10 million in funding for free tax preparation programs, an effort that should be included in any RAL legislation.

#### **4. Support for Bringing Unbanked Consumers into the Financial Mainstream**

Bank accounts are critical to reducing high cost loans secured by an expected refund. Taxpayers who want quick refunds can receive them in 8 to 15 days if they file electronically, but only if they have a bank account into which Treasury can direct deposit the refund. Thus, unbanked taxpayers cannot take advantage of free fast refunds. Having a bank account directly influences whether a consumer gets a RAL. One study found that consumers without bank accounts are twice as likely as banked consumers to get RALs.

Thus, any bill to address RALs should provide support for efforts to help the over 10 million U.S. households who lack a bank account. These 10 million households include a significant portion of EITC recipients, with one study showing that only about 40 percent of EITC recipients have a checking account.

#### **5. Permit Taxpayers to File Electronically Directly with the IRS**

The IRS should provide free direct electronic filing through the IRS website. Currently, taxpayers must go through a commercial third party website in order to file electronically or use the IRS-established Free File program if eligible. Free Internet filing would save taxpayers the fees charged by some commercial preparers for electronic filing, avoid the cross-marketing of high cost, high risk products sold by some preparers, and safeguard the privacy and security of tax return information filed directly from the taxpayer to the IRS without going through commercial hands. Since the IRS has failed to issue regulations to safeguard taxpayers' tax return information from being sold, shared or used for purposes other than complying with the legal obligation to file tax returns with the IRS, Congress must act to protect taxpayer privacy.

#### Paying for Tax Preparation without a RAL

Finally, we would like to address the issue of paying for tax preparation without a RAL. It is true that one of the reasons that consumers use RALs is to pay for tax preparation. This is a frequent argument made against restricting the ability of tax preparers and banks to make RALs. However, this argument is easily refuted, because there are several options for a consumer to pay for tax preparation without a RAL and being required to come up with \$150 in cash. These include:

- Split refunds - This year, the IRS has started allowing taxpayers to electronically deposit their tax refunds in up to three accounts with Form 8888. Refunds can be split by depositing into both checking and savings accounts. The IRS could allow a split refund to be directed to an account to pay for tax preparation.

- Refund anticipation check (RACs) - This is a non-loan refund financial product offered by all of the RAL lenders and tax preparers. While still expensive, RACs do cost less than RALs and do not bear the risks of RALs.

We thank you for your support in the efforts to combat RALs and your consideration of these proposals. If you have any questions about this letter, please contact Chi Chi Wu at National Consumer Law Center (617-542-8010) or Jean Ann Fox at Consumer Federation of America (757-867-7523).

Sincerely,

Chi Chi Wu  
National Consumer Law Center  
(on behalf of its low-income clients)

Jean Ann Fox  
Consumer Federation of America

Edmund Mierzwinski  
U.S. Public Interest Research Group

Linda Sherry  
Consumer Action

Peter Skillern  
Community Reinvestment Ass'n  
of North Carolina

Mark Winston Griffith & Chris Keeley  
Neighborhood Economic Development  
Advocacy Project

Marva Williams  
Woodstock Institute

Alan Fisher & Rhea Serna  
California Reinvestment Coalition

David Marzahl  
Center for Economic Progress

Brenda Muñiz  
ACORN National

Kimberley Chin  
The Children's Defense Fund

Clifford N. Rosenthal  
National Federation of  
Community Development Credit Unions

Michael Calhoun  
Center for Responsible Lending

Lucy Gorham  
Carolina EITC Initiative

MaryBe McMillan  
North Carolina AFL-CIO

Lynice Williams  
North Carolina Fair Share

Ajamu Dillahunt  
North Carolina Justice Center

Jon Parker  
Good Works

Shayna Simpson-Hall  
North Carolina IDA Collaborative

Sorien Schmidt  
Action for Children

Peter Laroche  
Consumer Credit Counseling Service  
of Forsyth County

Rachel Iskow  
Sacramento Mutual Housing Association

Heidi Li & Maeve Elise Brown  
Housing and Economic Rights  
Advocates

Nancy T. Swift  
Jefferson Economic  
Development Institute (JEDI)

Lynette Jung Lee  
East Bay Asian Local  
Development Corporation

Corinne Florek  
JOLT Coordinator

Vince Vuong  
LISC Los Angeles

Sylvia Rosales-Fike  
Anewamerica Community Corporation

Mona Breed  
Sentinel Fair Housing, Oakland, CA

Rodney Fernandez  
Cabrillo Economic Development Corp.

Deb Howard & Bonita Dowling  
Pratt Area Community Council

Michael Wigutow  
Nassau/Suffolk Law Services Committee

Merrilee Witherell  
Fair Housing Council  
of Central New York

Robert J. Brand  
Solutions for Progress, Inc.

Joanna Smith-Ramani  
Baltimore CASH Campaign

Kim Jacobs  
Community Capital Resources

Randall Chapman  
Texas Legal Services Center

Alan Jennings  
Community Action Committee of the Lehigh Valley

Junious Williams, Andy Nelsen and Lisa Forti  
Urban Strategies Council

Peggy Jones  
Nehemiah Community Reinvestment Fund

Hector A. Fernandez  
Rural Community Assistance Corporation

Douglas J. Bystry  
Clearinghouse CDFI – Lake Forest, CA

Andy Nelsen  
Urban Strategies Council

Claudia Viek  
CAMEO

Craig Gurion  
Anti-Discrimination Center of Metro New York

Russ Haven  
New York Public Interest Research Group

Michelle Santantonio, Executive Director  
Long Island Housing Services

Ruhi Maker  
Empire Justice Center

Dory Rand  
Sargent Shriver National Center on Poverty Law

Robin McKinney  
Maryland Asset Building Initiative  
Maryland CASH Campaign

Jean Hunt  
Campaign for Working Families

Bill Newton  
Florida Consumer Action Network

Brad Ashwell  
Florida PIRG

Patti O'Callaghan  
Lafayette Urban Ministry

Jennifer Williams  
Maryland Committee for Children

Lynn Drysdale  
Jacksonville Area Legal Aid

James W. (Jay) Speer  
Virginia Poverty Law Center

Irene E. Leech  
Virginia Citizens Consumer Council

Bonnie Esposito  
AccountAbility Minnesota

Daniella Levine  
Human Services Coalition

Al Sterman  
Democratic Processes Center

Catherine Barnett  
Project Enterprise

Paul Peninger  
Non-Profit Housing Association  
of Northern California

Dan McCurry  
Chicago Consumer Coalition

Andrew Galli  
Maryland Consumer Rights Coalition

Jennifer Williams  
Maryland EIC Campaign

Phyllis Rowe  
Arizona Consumers Council

Helen M. O'Beirne, MSW  
Virginia Partnership to  
Encourage Responsible Lending (VaPERL)

Linda Hilton  
Coalition of Religious Communities

Paul Schlaver  
Massachusetts Consumers' Coalition

Johanna E. Neumann  
Maryland Public Interest Research Group (PIRG)

Kerry Smith  
Community Legal Services - Philadelphia

Merrilee Witherell, Executive Director  
Fair Housing Council of Central New York

Karen Heisler  
Consumer Credit Counseling Service of MT, Inc. -  
Tax Help Montana